

the Council on this issue at its next meeting in April, 1988. After receiving affirmative advice from the Council, the Regional Director decided to postpone action until after the majority of crabs in Zone 1 had completed their molting and mating cycle in mid-June, 1988, to reduce bycatch mortality. Certain administrative and legal requirements then necessitated publication of the proposed action (in August) and opportunity for public comment (ending September 21, 1988). Although this process has been lengthy, it was not designed to inhibit DAP fishing operations but to protect the interests of all persons concerned with marine fishery resources. This process could have been shorter if the specific circumstances and conditions leading to the request for this reopening were anticipated in implementing the original Zone 1 rule. Public comment on the potential reopening of Zone 1 at that time would have obviated the need for it now.

The processor preference amendments to the Magnuson Act provide U.S. fish processors priority access to U.S. harvested fish. Foreign processing vessels' access to U.S. harvested fish is restricted by decisions to apportion amounts of fish to JVP or DAP. Prohibited species are not part of the groundfish fishery as defined in the FMP, and may not be processed by U.S. or foreign processors. While fishing for a species of groundfish may be predicated on the availability of uncaught PSC limits, this FMP does not express the Council's intent that certain U.S. harvesters be given priority access to PSC species.

**Comment 2:** Too many crabs and juvenile halibut are being taken out of Zone 1 as bycatch in the trawl fisheries. Yellowfin sole can be harvested in adjacent areas (north and west) of Zone 1 without as much potential impact on the longline fishery for halibut. Bering Sea populations of red king and (*C. bairdi*) Tanner crabs have been characterized by the State of Alaska Department of Fish and Game as depressed. The conservation of crabs and halibut should prevail over the desires of groundfish fisheries in Zone 1.

**Response:** Estimates of the numbers of crabs and halibut taken as bycatch in the Bering Sea groundfish fisheries are high. The critical issue here, however, is whether the incremental bycatch that will occur by reopening Zone 1 will significantly add to the risk of overfishing these prohibited species. The Regional Director has determined that the additional bycatch mortality of *C. bairdi* Tanner crabs, and Pacific halibut, up to the supplemental PSC limits prescribed below, is not likely to overfish the species. Red king crab bycatches in a reopened Zone 1 are not expected to attain the existing PSC limit for this species. These determinations did take into consideration the relatively low population levels of mature red king and *C. bairdi* Tanner crabs. Although commercial harvests of yellowfin sole and "other flatfish" have occurred outside of Zone 1, the allowance of fishing for these species within the zone balances the economic interests of groundfish fishermen with the conservation interests of crab fishermen.

#### Closure Modification and Conditions

Directed fishing for yellowfin sole and "other flatfish" by DAP fishing vessels will be allowed to resume on the effective date in Zone 1 providing that those vessels comply with the following conditions:

1. Any DAP fishing vessel on which trawl-caught groundfish are brought onboard must carry an observer approved by the Regional Director.
2. Directed fishing for yellowfin sole and "other flatfish" will cease by notice in the Federal Register when any of the following occurs:

(a) The total number of red king crabs taken by JVP and DAP vessels while directed fishing for yellowfin sole and "other flatfish" in Zone 1 since the beginning of the 1988 fishing year equals the PSC limit of 135,000 animals;

(b) The total number of *C. bairdi* Tanner crabs taken by JVP and DAP vessels while directed fishing for yellowfin sole and "other flatfish" in Zone 1 after this notice became effective equals the supplemental PSC limit of 50,000 animals;

(c) The total number of Pacific halibut taken by JVP and DAP vessels while directed fishing for yellowfin sole and "other flatfish" in Zone 1 after this notice became effective equals the supplemental PSC limit of 60,200 animals.

#### Classification

This action is taken under authority of § 675.21(d). For the reasons stated above, the Under Secretary for Oceans and Atmosphere, NOAA, (Under Secretary) has determined that this action is necessary and consistent with the Magnuson Act. In addition, based on the above discussion and the Regional Director's determinations, the Assistant Administrator for Fisheries, NOAA, (Assistant Administrator) has determined that this action: (1) Qualifies for a categorical exclusion from the requirement to prepare an environmental assessment under the National Environmental Policy Act, (2) is not a major rule requiring regulatory impact analysis under Executive Order 12291, (3) will have no significant effects on small entities under the Regulatory Flexibility Act, and (4) contains no collection of information requirement subject to the Paperwork Reduction Act. However, the Under Secretary finds that the Regional Director's determinations substantially satisfy the environmental and economic documentation requirements of these laws.

The reopening of Zone 1 to directed fishing for yellowfin sole and "other flatfishes" by U.S. vessels relieves a restriction and is not subject to the delayed effectiveness period required by the Administrative Procedures Act (APA). However, for operation purposes, the effective date of this action is delayed to ensure a fair start.

#### List of Subjects in 50 CFR Part 675

Fish, Fisheries, Reporting and recordkeeping requirements.

Authority: 16 U.S.C. 1801 *et seq.*

Dated: December 8, 1988.

James W. Brennan,

Assistant Administrator for Fisheries,  
National Marine Fisheries Service.

[FR Doc. 88-28589 Filed 12-8-88; 8:45 am]

BILLING CODE 3510-22-M

# Proposed Rules

Federal Register

Vol. 53, No. 239

Tuesday, December 13, 1988

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## NUCLEAR REGULATORY COMMISSION

### 10 CFR Part 50

#### Public Meeting on Notice of Proposed Rulemaking on Maintenance of Nuclear Power Plants

**AGENCY:** Nuclear Regulatory Commission.

**ACTION:** Notice of meeting.

**SUMMARY:** On November 28, 1988 (53 FR 47822), the Commission published a notice of proposed rulemaking on maintenance of nuclear power plants. This meeting is scheduled as a result of a request from Nuclear Management and Resources Council (NUMARC). The agenda for the meeting will mainly include time for NRC staff responses to questions from NUMARC on the notice of proposed rulemaking including the Commission's solicitation of proposals for the development of a maintenance standard.

**DATE:** 1:00 p.m., December 14, 1988.

**ADDRESS:** Room 4B11, One White Flint North, 11155 Rockville Pike, Rockville, MD 20852.

**FOR FURTHER INFORMATION CONTACT:** Moni Dey, Office of Nuclear Regulatory Research, U.S. Nuclear Regulatory Commission, Washington, DC 20555. Telephone (301) 492-3730.

Dated in Rockville, Maryland this 6th day of December, 1988.

For the Nuclear Regulatory Commission.

Moni Dey,

Task Manager, Advanced Reactors & Generic Issues Branch, Division of Regulatory Applications, Office of Nuclear Regulatory Research.

[FR Doc. 88-28629 Filed 12-12-88; 8:45 am]

BILLING CODE 7590-01-M

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Parts 229, 240, 249, 270, and 274

[Rel. Nos. 34-26333; 35-24768; IC-16669; File No. S7-26-88]

#### Ownership Reports and Trading by Officers, Directors and Principal Stockholders

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rules.

**SUMMARY:** The Commission today is publishing for comment proposed revisions to its rules and forms regarding the filing of ownership reports by corporate officers, directors, and principal shareholders, and the exemption of certain transactions by those persons from the short-swing profit recovery provisions of the Securities Exchange Act of 1934 and related provisions of the Investment Company Act of 1940 and the Public Utility Holding Company Act of 1935. The Commission proposes to revise these rules to achieve greater clarity, enhance consistency with the statutory purposes, rescind unnecessary requirements, streamline mandated procedures, and enhance compliance with the reporting provisions of the rules.

**DATE:** Comments should be received on or before March 13, 1989.

**ADDRESS:** Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. Comment letters should refer to File No. S7-26-88.

All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549.

**FOR FURTHER INFORMATION CONTACT:** Brian J. Lane, Elizabeth M. Murphy, or Mark W. Green, Office of Disclosure Policy, Division of Corporation Finance, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549 (202) 272-2589.

**SUPPLEMENTARY INFORMATION:** The Commission is publishing for comment a comprehensive revision of its rules

promulgated under section 16<sup>1</sup> of the Securities Exchange Act of 1934 ("Exchange Act").<sup>2</sup> Every rule under section 16 would be amended, deleted, or reorganized except for Rule 16c-1<sup>3</sup> and Rule 16e-1.<sup>4</sup> Further, Exchange Act Rule 12h-2<sup>5</sup> would be deleted and Rule 30f-1<sup>6</sup> under the Investment Company Act of 1940 ("Investment Company Act")<sup>7</sup> would be amended.

In addition, the Commission is proposing changes to Regulation S-K,<sup>8</sup> Schedule 14A,<sup>9</sup> and Forms 10-K,<sup>10</sup> 3,<sup>11</sup> and N-SAR.<sup>12</sup> The Commission also is proposing a new Form 5.

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<sup>1</sup> 15 U.S.C. 78p (1982).

<sup>2</sup> 15 U.S.C. 78a et seq. (1982).

<sup>3</sup> 17 CFR 240.16c-1.

<sup>4</sup> 17 CFR 240.16e-1.

<sup>5</sup> 17 CFR 240.12h-2.

<sup>6</sup> 17 CFR 270.30f-1.

<sup>7</sup> 15 U.S.C. 80a-1 et seq. (1982).

<sup>8</sup> 17 CFR 229.10-229.802.

<sup>9</sup> 17 CFR 240.14a-101.

<sup>10</sup> 17 CFR 249.310.

<sup>11</sup> 17 CFR 249.103; 17 CFR 249.104.

<sup>12</sup> 17 CFR 274.101.

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## I. Executive Summary

Section 16(a) of the Exchange Act<sup>13</sup> requires that the officers, directors, and principal shareholders of an issuer with equity securities registered under section 12<sup>14</sup> disclose the extent of, and changes in, their ownership of equity securities of that issuer. Under section 16(b),<sup>15</sup> the issuer may recover trading

profits realized by those persons incident to short-swing transactions in the issuer's equity securities.

The amendments proposed today reflects the first comprehensive review of the regulatory scheme under section 16 since the adoption of the Exchange Act. There currently are two forms and 25 rules in place, of which only five rules have been revisited within the past 18 years. These regulations have been the subject of frequent and continuous requests for interpretive advice. A fresh look at the rules also is warranted in light of changes in the nature of securities. Trading has mushroomed in both old and new derivative securities,<sup>16</sup> and employee benefit plans have become more widespread, complex, and diverse. Fitting these developments into the existing regulatory framework has resulted in interpretive uncertainty, substantial litigation, and, in some instances, unnecessary regulatory burdens. Further, in light of the widespread delinquency of corporate insiders in meeting their reporting responsibilities under section 16(a), the regulatory scheme under section 16 should be amended to improve compliance and detection of delinquent filers.

Major substantive changes proposed in the regulatory scheme include: (1) Specific definitions of the terms "beneficial owner," "equity security of such issuer," and "officer;" (2) a definition of the term "owner of any equity security of the issuer" that would address the criteria for standing in private suits under section 16(b); (3) use of a new Form 5 for the annual reporting of transactions that are exempted from short-swing profit recovery and transactions that are required to be reported, but were not; (4) a provision requiring insiders to provide the issuer with copies of their Forms 3, 4, and 5; (5) deletion of the shareholder approval provision of the employee benefit plan rule, Rule 16b-3, and inclusion of a more stringent disinterested administration requirement; (6) a change in the reporting date for derivative securities to the date of acquisition, rather than the date the securities become exercisable; (7) exemption of most exercises and conversions of derivative securities from short-swing profit recovery; (8) inclusion of derivative securities in the same class of securities as the underlying securities; (9) alternative profit calculation measures for short-swing transactions involving derivative securities; (10) imposition of

reporting status on trusts when the trustee is a reporting person; (11) an exemption from section 16(c) for a short derivative securities position that hedges an underlying securities position; (12) amendment of the proxy rules to require issuers to disclose late reporting by their insiders in the annual proxy statement and annual report on Form 10-K; and (13) a provision that a section 16(a) report be deemed timely filed with the Commission if the filing person shows that the report was mailed to the Commission by the due date. Apart from substantive changes, the rules under section 16 are proposed to be reorganized to provide greater clarity.

## II. Background

Section 16 of the Exchange Act was designed both to provide the public with information on securities transactions and holdings of corporate officers, directors, and principal shareholders, and to deter those individuals from profiting on short-term trading in the securities of their corporations while in possession of material, non-public information. It applies to every person who is directly or indirectly the beneficial owner of more than ten percent of any class of equity security that is registered pursuant to section 12 of the Exchange Act ("ten percent holders"), and to every director and officer of such issuer (collectively referred to as "insiders").

The legislative history of the Exchange Act describes in detail instances where insiders with advance knowledge of facts that could produce a rise or fall in the market value of their companies' securities bought and sold such securities to their personal advantage.<sup>17</sup> In some cases, insiders manipulated the market price of their stock and caused the company to follow financial policies calculated to produce sudden changes in market prices. To combat these abuses, Congress enacted section 16 to require reports of securities transactions by insiders and to provide for the recovery of any short-swing profits.<sup>18</sup>

<sup>17</sup> See generally *Stock Exchange Practices: Hearings on S. Res. 84 and S. Res. 56 and S. Res. 97 Before the Senate Comm. on Banking and Currency, 73d Cong., 1st Sess. 55 (1934)* [hereinafter "Stock Exchange Practices"].

<sup>18</sup> Substantially identical provisions appear as sections 17(a) and 17(b) of the Public Utility Holding Company Act of 1935 [15 U.S.C. 79(a), (b) (1982)], and the reporting requirements of section 16 are adapted in section 30(f) of the Investment Company Act [15 U.S.C. 80a-29(f) (1982)]. The exemptive rules under section 16 also are applicable to these parallel statutory provisions.

<sup>13</sup> 15 U.S.C. 78p(a) (1982).

<sup>14</sup> 15 U.S.C. 78b (1982).

<sup>15</sup> 15 U.S.C. 78p(b) (1982).

<sup>16</sup> The term "derivative securities" refers to convertible securities, options, warrants, and similar rights.

"For the purpose of preventing the unfair use of information which may have been obtained by [an insider] by reason of his relationship to the issuer,"<sup>19</sup> Congress enacted section 16(b), which provides for automatic recovery of any profits made by an insider on securities purchased and sold within a six month period. Unlike other provisions applicable to insider trading, i.e., sections 10(b), 14(e), and 21(d)(2) of the Exchange Act,<sup>20</sup> section 16 is a strict liability provision under which an insider's short-swing profits can be recovered regardless of whether that insider actually was in possession of material, non-public information.<sup>21</sup> Congress used this "automatic recovery provision [to] cut [ ] through the formidable difficulties on proving intent and actual misuse of inside information that serve to hinder the effectiveness of traditional remedies against insider speculation."<sup>22</sup> The Commission was given specific rulemaking authority to exempt transactions as not comprehended within the purpose of the subsection.

Believing prompt publicity to be a potent weapon in the effort to curb the abuse of inside information, Congress also adopted section 16(a), which requires insiders to file public reports with respect to transactions in the equity securities of their corporations. In mandating reporting by insiders, Congress intended not only to discourage abuse of inside information and encourage voluntary maintenance of proper fiduciary standards by those in control of corporations, but also to give public investors information concerning purchases and sales by insiders, which might in turn indicate such insiders' private opinions of the company's prospects.<sup>23</sup> Reflecting this additional informational purpose, the exemptive rules from section 16(b) short-swing profit liability do not exempt an insider from reporting under section 16(a), while a reporting exemption carriers with it an exemption from section 16(b).<sup>24</sup>

Section 16(c)<sup>25</sup> prohibits the sale of any equity security of the issuer if the selling insider either (1) does not own the security, or (2) does not deliver it within 20 days after sale or mail it within five days. However, Congress provided an exception for persons who, acting in good faith, were unable to deliver in time or were able to prove that timely delivery would have caused undue inconvenience or expense.

When Congress added section 12(g)<sup>26</sup> to the Exchange Act to extend Exchange Act registration requirements to securities traded in the over-the-counter market in 1964, section 16(d)<sup>27</sup> was added to provide an exemption from section 16 (b) and (c) for over-the-counter marketmakers. Only trades executed in the ordinary course of market making activities are exempt; trading involving a marketmaker's investment account is not. This provision also gives the Commission rulemaking authority to define and prescribe conditions regarding investment accounts and market maintenance.

Section 16(e)<sup>28</sup> provides an exemption for "foreign and domestic arbitrage transactions unless made in contravention of such rules and regulations as the Commission may adopt in order to carry out the purposes of this section." Unlike section 16(d), this exemption explicitly provides relief from section 16(a) as well as from sections 16 (b) and (c).

The current regulatory scheme requires insiders to file a Form 3, Initial Statement of Beneficial Ownership of Securities, with the Commission when a company first registers an equity security pursuant to section 12, or when an insider otherwise becomes subject to the reporting requirements of section 16(a).<sup>29</sup> A copy of the report also must be forwarded to each national securities exchange on which the registered security is listed.<sup>30</sup>

Subsequently, an insider must file a Form 4, Statement of Changes in Beneficial Ownership of Securities, for any month in which there has been a change in the beneficial ownership last reported on a Form 3 or Form 4, except for changes resulting from transactions exempted from the reporting requirements. The Form 4 must be filed within ten days of the end of the month in which the change in beneficial ownership occurs.<sup>31</sup>

In light of the importance of the information provided by Form 4 filings to investors, many major newspapers<sup>32</sup> routinely publish information gleaned from the reports filed by insiders of selected companies, such as those of local interest. Moreover, there are a number of private newsletters and services that analyze or report trades by reporting persons.<sup>33</sup> Analysts and investors routinely monitor insider trades to detect early warning signs of trouble or positive trends among companies.<sup>34</sup>

The staff of the Division of Corporation Finance receives more requests for interpretative and no-action advice concerning the section 16 rules than any other area.<sup>35</sup> This is due, in

<sup>31</sup> Form 4 requires disclosure of the date of transaction, amount of securities, price, amount owned at the end of the month, and nature of beneficial ownership.

<sup>32</sup> E.g., *The Wall Street Journal*, *USA Today*, *The Chicago Tribune*, *The Philadelphia Inquirer*, *The Washington Post*.

<sup>33</sup> Numerous studies have been conducted as to the value of tracking insider transactions. See, e.g., "Bullish" Insider-Trade Data May Mislead, *Wall St. J.* at C1, col. 3 (Nov. 30, 1988); Scholes, "The Market for Securities: Substitution Versus Price Pressure and the Effects of Information on Share Prices," 45 *J. Bus.* 179 (1972), as cited in Carney, "Signalling and Causation in Insider Trading," 36 *Cath. U.L. Rev.* 863, 889 (1987); Baesel and Stein, "Value of Information: Inferences from the Probability of Insider trading," 14 *J. Fin. & Quantitative Analysis* 553 (1979), as cited in Cox "Insider Trading and Contracting: A Critical Response to the 'Chicago School,'" *Duke L.J.* 628 (Sept. 1986); Rose, *Tracking the Trades of Corporate Insiders Doesn't Always Give an Edge to Investors*, *Wall St. J.* Dec. 19, 1985 at 31, col. 4; Bilson and Kraakman, "The Mechanisms of Market Efficiency," 70 *Va.L.Rev.* 549 (1984).

<sup>34</sup> See, e.g., Dorfman, *Journal Launches Insider Trading Feature*, *Wall St. J.*, Aug. 31, 1988, at 28 col. 3; Boland, *Those Tardy Insider Filings*, *NY Times*, Jan. 24, 1988, § 3, at 8, col. 4; Novack, *Stale Dope*, *Forbes*, Nov. 2, 1987, at 180; Boland, *The Insiders Turn Surprisingly Bullish*, *NY Times*, Jul. 12, 1987, at 10, col. 1; Scheibla, *Better Never Late*, *Barron's*, Oct. 20, 1986, at 15; McFadden, *Companies The Bosses Bet On*, *Fortune*, Jul. 21, 1986, at 112; Koretz, *Tracking Corporate Insiders to Get in on a Good Thing*, *Bus. Wk.*, May 19, 1986, at 34; Marcial, *Taking a Cue from Company Insiders*, *Bus. Wk.*, May 12, 1986, at 88.

<sup>35</sup> Since 1971, the staff has issued over 2000 no-action letters that have addressed section 16. About 190 section 16 letters were issued in 1987 and 200 letters in the first ten months of 1988.

<sup>19</sup> 15 U.S.C. 78p(b) (1982).

<sup>20</sup> 15 U.S.C. 78j(b), 78n(e) (1982), 78u(d)(2)(A) (Supp. III 1985); see Rule 10b-5 [17 CFR 240.10b-5]; Rule 14e-3 [17 CFR 240.14e-3].

<sup>21</sup> Unlike other provisions of the Exchange Act, section 17(b) is enforced by shareholders bringing derivative actions on behalf of the issuer, rather than by the Commission or by shareholders directly pursuing claims for damages.

<sup>22</sup> S. Rep. No. 379, 88th Cong., 1st Sess. 9 (1963).

<sup>23</sup> H. Rep. No. 1383, 73d Cong., 2d Sess. 13, 24 (1934).

<sup>24</sup> See current Rule 16a-10 [17 CFR 240.16a-10]; proposed Rule 16a-10.

<sup>25</sup> 15 U.S.C. 78p(c) (1982).

<sup>26</sup> 15 U.S.C. 78l(g) (1982).

<sup>27</sup> 15 U.S.C. 78p(d) (1982).

<sup>28</sup> 15 U.S.C. 78p(e) (1982).

<sup>29</sup> The Form 3 must be filed within ten days after an officer, director or ten percent holder achieves such status. If, however, the reporting person already occupies such a position at the time of the initial registration pursuant to section 12, the Form 3 must be filed by the time the registration becomes effective. Form 3 requires disclosure of the title of the securities held, the amount of securities directly or indirectly owned, the nature of the beneficial ownership, the relationship of the reporting person to the issuer, the date of the event triggering the reporting requirement, and other related information.

<sup>30</sup> 15 U.S.C. 78p(a) (1982).

large part, to the complexity of the rules and continual changes in the market, including the increasing number of types of unorthodox transactions and constantly evolving employee benefit plan arrangements. In the last five years, there have been repeated requests from the corporate community,<sup>36</sup> the securities industry,<sup>37</sup> and the securities bar<sup>38</sup> that the Commission revisit the section 16 regulatory scheme.

Furthermore, the Commission is concerned that the rate of delinquency in Form 3 and 4 filings has become very high in the past several years.<sup>39</sup> A number of enforcement actions to enforce filing requirements have been and continue to be brought.<sup>40</sup> To address the reporting problem, the Commission is proposing a four-part response: (1) Simplifying the reporting provisions to focus on timely reporting of those securities transactions that are more discretionary in nature and have greater potential for abuse;<sup>41</sup> (2) providing for annual reporting by insiders of their securities ownership and previously unreported transactions; (3) requiring annual disclosure by companies of those insiders who have failed to comply with the filing requirements within the past year; and (4) supporting legislation to provide for fines for late filings.<sup>42</sup>

<sup>36</sup> Letter to Catherine C. McCoy, Associate Director, Division of Corporation Finance, from Richard H. Troy, Chairman, Securities Law Committee, American Society of Corporate Secretaries, Inc. (Oct. 11, 1984).

<sup>37</sup> Letter to John J. Huber, Director, Division of Corporation Finance, from Saul S. Cohen, Chairman, Federal Regulations Committee, Securities Industry Association (Oct. 20, 1983).

<sup>38</sup> Letter to John J. Huber, Director, Division of Corporation Finance, from Donald W. Glazer, Co-Chairman, Simon M. Lorne, Co-Chairman, and Timothy Tomlinson, Secretary, American Bar Association Subcommittee on Employee Benefits and Executive Compensation (Nov. 9, 1983).

<sup>39</sup> A study conducted by the Commission's staff has revealed a delinquency rate in excess of 40 percent for the years 1986, 1987, and 1988. See Section VII.A. *infra*.

<sup>40</sup> See, e.g., *SEC v. Beall*, Litigation Release No. 11325 (Jan. 6, 1987); *SEC v. Lee*, Litigation Release No. 11191 (Aug. 11, 1986).

<sup>41</sup> As part of the effort to make the rules less complex, minor language changes to some of the current rules would be proposed. See proposed Rules 16a-5(b), 16a-6, 16a-7, 16b-7, and 16b-8.

<sup>42</sup> The Commission has proposed legislation, the "Securities Law Enforcement Remedies Act of 1988," to amend section 15(c)(4) of the Exchange Act [15 U.S.C. 78o(c)(4)] [Supp. III 1985]] to include authority for section 16(a) non-compliance, which would, as a result, provide fining authority for section 16(a). This legislative proposal was forwarded to Congress on September 28, 1988.

### III. Section 16(a) Reporting

#### A. Who Must Report

The proposed rules would clarify the meaning of the terms "officer" and "ten percent beneficial owner."

##### 1. Officer

Proposed Rule 16a-1(g) would define "officer" for section 16 purposes in the same manner as "executive officer" is defined in Rule 3b-7.<sup>43</sup>

In applying the definition of "officer" currently applicable to section 16, which is currently contained in Rule 3b-2,<sup>44</sup> courts have construed the term to encompass only those officers who have access to non-public information,<sup>45</sup> excluding officers who hold only an honorary title or who have no significant executive duties and do not participate in management decisions.<sup>46</sup> If applied literally, the Rule 3b-2 definition of "officer" can be too broad in the context of section 16; of particular concern is the inclusion of all vice presidents in the definition.<sup>47</sup> Many businesses give the title of vice president to employees who do not have significant managerial or policymaking duties and are not privy to inside information.

The reporting and short-swing profit recovery provisions of section 16 were intended to apply to those officers who have routine access to material non-public information, not those with particular titles. The Commission, therefore, proposes to amend the definition of officer to parallel the Exchange Act definition of the term executive officer. Those exercising a policy-making function, by the very nature of that responsibility, have routine access to material non-public information. Officers without policy-making responsibility are not as likely to have such access and, therefore, should not be subject to the reporting and automatic liability provisions of Section

<sup>43</sup> 17 CFR 240.3b-7.

<sup>44</sup> "The term 'officer' means a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization whether incorporated or unincorporated." 17 CFR 240.3b-2.

<sup>45</sup> See, e.g., *C.R.A. Realty Corp. v. Crotty*, 663 F. Supp. 444 (S.D.N.Y. 1987).

<sup>46</sup> See Exchange Act Release No. 18114 (Sept. 24, 1981) [46 FR 48147] [hereinafter "Release 34-18114"] Question 1(c); *Merrill Lynch Pierce Fenner & Smith, Inc. v. Livingston*, 566 F.2d 1119 (9th Cir. 1978).

<sup>47</sup> Report of the Task Force on Regulation of Insider Trading Part II: Reform of Section 16, 42 Bus. Law. 1087 (1987) (American Bar Association report). A recent survey by the American Society of Corporate Secretaries reveals that approximately 30 percent of the members responding used the Rule 3b-7 definition to determine which officers are subject to section 16. American Society of Corporate Secretaries, "Section 16 Survey Report" (Nov. 1988).

16. Should these officers in fact come into possession of material non-public information, the Exchange Act antifraud provisions will prohibit their abuse of the information and impose liability for profits made or losses avoided.<sup>48</sup> The Commission does, however, solicit comment on whether "officer" should instead be defined to include all officers with routine access to inside information, whether or not they are executive officers.

The proposed definition, like Rule 3b-7, specifically addresses officers of the issuer's subsidiary, but not officers of a parent. Comment is solicited as to whether the rule also should make it clear, consistent with current interpretation, that an officer of the issuer's parent company who performs policy-making functions for the issuer is deemed an officer of the issuer.

##### 2. Director

No definition for the term "director" is proposed because there appears to be little confusion about the definition of that term in section 3(a)(7) of the Exchange Act.<sup>49</sup> Comment is solicited, however, as to whether a definition specific to section 16 is necessary.

The Commission does not propose to codify case law relating to deputization. Under that theory, a corporation, partnership, trust or other person can be deemed a director for purposes of section 16 where it has expressly or impliedly "deputized" an individual to serve as its representative on a company's board of directors. In determining whether a person has been deputized for purposes of section 16, the courts have looked at a variety of factors, focusing primarily on the alleged deputy's position of control within the deputizing entity and the deputy's independent qualifications to serve on the board of the issuing corporation.<sup>50</sup> This fact-intensive analysis appears best left to a case-by-case determination. Nonetheless, comment is

<sup>48</sup> See Exchange Act sections 10(b), 14(e), 21(d)(2)(A).

<sup>49</sup> 15 U.S.C. 78c(a)(7) (1982).

<sup>50</sup> See *Blau v. Lehman*, 368 U.S. 403 (1962); *Feder v. Martin Marietta*, 406 F.2d 260 (2d Cir. 1969); *Lowey v. Howmet Corp.*, 424 F. Supp. 461 (S.D.N.Y. 1977); *Lewis v. The DeKroft Corp.*, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶94,620 (S.D.N.Y. 1974). Although most of the cases involving deputization have not addressed specifically whether deputizing entities are subject to the reporting requirements of section 16(a), the court stated in *Sterling v. Chemical Bank*, 382 F. Supp. 1146 (S.D.N.Y.), *aff'd*, 516 F.2d 1396 (2d Cir. 1975), that the concept of deputization has never been extended to that section. The Commission, however, stated in Release 34-18114, Q.3, that a person who designates another to be a director should be deemed a director for purposes of section 16(a).

requested as to whether further guidance is needed either by codification of current judicial interpretation or otherwise.

In making a determination as to whether a particular advisory, emeritus, or honorary director should be treated as a director for purposes of section 16, the focus should be on such person's underlying responsibilities or privileges with respect to the issuer and access to inside information. The person's formal title does not govern that determination. In general, honorary directors need not be treated as directors for purposes of section 16, because they usually do not take part in formulating and deciding policy issues concerning the issuer, and do not have general access to material, non-public information.<sup>51</sup> On the other hand, advisory and emeritus directors generally should be treated as directors for such purposes.<sup>52</sup> They commonly are invited to attend board meetings of the issuer to assist in policy formation and, therefore, do have access to material, non-public information.

### 3. Transactions While not an Officer or Director

Rule 16a-1(d)<sup>53</sup> currently requires an officer or director (but not a ten percent holder)<sup>54</sup> to disclose all trades conducted six months before becoming an insider. This requirement would be retained in proposed Rule 16a-2(a), because, once becoming an officer or director and gaining access to inside information, a person would have the opportunity to take advantage of that information to offset transactions made shortly before attaining insider status.

Comment is requested as to whether it is useful to require disclosure of trades made by insiders prior to attaining insider status. If so, should the transaction effected prior to becoming an insider nonetheless be exempted from section 16(b) profit recapture because the insider may not have known at the time of that transaction that the initial transaction could be subject to profit recovery?

Proposed rule 16a-2(b) would continue to require that an officer or director disclose all trades executed six months after termination of insider

status or termination of section 12 registration for the class of securities. An insider's leaving office does not diminish the ability to develop a plan to purchase and sell or sell and purchase while in possession of inside information.

### 4. Beneficial Owners

The third class of reporting persons is ten percent beneficial owners. The term beneficial ownership under section 16 has evolved under case law and is not specifically defined in the Exchange Act or the Commission's rules. Uncertainty as to the status of indirect interests in securities of the issuer, such as ownership of derivative securities and holdings of the immediate family, trusts, corporations, and partnerships, has raised requests for a definition.

Congress, in applying Section 16 to ten percent holders, intended to reach those persons who could be presumed to have access to inside information because of their interest in the issuer's securities. Thus, in determining beneficial ownership for purposes of ascertaining who is a ten percent holder, the analysis properly should turn on the person's potential for control. The proposed rules would rely on section 13(d) definitions for determining who is a ten percent holder.<sup>55</sup> The identification of ten percent holders by the issuer will be facilitated by use of schedule 13D reports.<sup>56</sup>

The determination of which securities transactions should be subject to section 16(a) reporting and section 16(b) profit recovery, on the other hand, should focus only on those transactions from which the insider may realize a profit. Rule 16a-1(a)(2), therefore, would define beneficial ownership for purposes of section 16(a) reports and section 16(b) profit recovery in terms of pecuniary interest, thereby codifying case law.<sup>57</sup> Inclusion of a specific definition of beneficial ownership for reporting and profit recovery purposes, particularly those provisions of the definition that address specific situations such as family and trust ownership, will provide for greater certainty. It will, however, substantially reduce the flexibility of the courts to take into account the facts and circumstances of a specific case that might militate against a finding of

beneficial ownership. For example, one court found beneficial ownership for reporting purposes and not recovery purposes.<sup>58</sup> Under the proposed definition that would no longer be possible. The Commission requests comment on the advisability of defining beneficial ownership for reporting and profit recovery purposes; would it be preferable to continue to allow the courts to proceed on a more flexible facts and circumstances analysis?

**a. Proposed Definitions—(i) Ten Percent Holder.** Proposed Rule 16a-1(a)(1) would state that a person would be deemed a ten percent holder for purposes of Section 16 if that person is deemed a ten percent beneficial owner under section 13(d) of the Exchange Act and the rules thereunder. All aspects of the section 13(d) analysis, such as the exclusion of non-voting securities<sup>59</sup> and counting only those derivative securities exercisable within 60 days,<sup>60</sup> would be imported into the ten percent holder determination for section 16 purposes.<sup>61</sup>

Proposed Rule 16a-2(c) would state that the transaction resulting in a person becoming a ten percent holder need not be reported,<sup>62</sup> although the existence of the holding would be required to be disclosed on the Form 3.<sup>63</sup>

**(ii) Pecuniary Interest.** The proposed definition of the term beneficial owner for reporting and profit recovery purposes in Rule 16a-1(a)(2) would include "any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares a pecuniary interest in the subject securities." It thus would codify the courts' emphasis on pecuniary interests and deem that indirect pecuniary interests are sufficient to establish a reporting obligation and the potential for short-swing profit recovery with respect to those securities.<sup>64</sup> **Use of voting**

<sup>51</sup> See *Colan v. Monumental Corp.*, 639 F.2d 818 (7th Cir. 1983) (derivative securities).

<sup>52</sup> 17 CFR 240.13d-1(d).

<sup>53</sup> 17 CFR 240.13d-3(d)(1).

<sup>54</sup> For example, just as with section 13(d), insiders could not purchase put options or write call options for the purpose of affecting ten percent holder status.

<sup>55</sup> The rule is in accord with the holding in *Foremost-McKesson v. Provident Securities Co.*, 423 U.S. 232 (1976) that such transactions would not be subject to section 16(b).

<sup>56</sup> There is less of a need for reporting such transactions on Form 4 since these trades would be reported on a Form 13D.

<sup>57</sup> Proposed Rule 16a-1(a)(2) would address specifically three forms of indirect pecuniary interests: Derivative securities, family holdings, and general partnership holdings.

<sup>51</sup> Release 34-18114 Q.2.

<sup>52</sup> *Id.*

<sup>53</sup> 17 CFR 240.16a-1(d).

<sup>54</sup> The rule was adopted in response to court decisions permitting short-swing profit recovery for transactions made prior to becoming an officer and director. See Exchange Act Release No. 8697 (Sept. 18, 1969) [34 FR 15246]; *Adler v. Klawans*, 267 F.2d 840 (2d Cir. 1959); *Blau v. Allen*, 163 F. Supp. 702 (S.D.N.Y. 1958). Section 16(b) expressly precludes short-swing profit recovery from ten percent holders unless they had that status at the time of both transactions. See proposed Rule 16a-2(c).

<sup>55</sup> See Proposed Rule 16a-1(a)(1); 15 U.S.C. 78m(d) (1982); 17 CFR 240.13d-1 *et seq.*

<sup>56</sup> 17 CFR 240.13d-101.

<sup>57</sup> See, e.g., *Whitaker v. Whitaker Corp.*, 639 F.2d 516 (9th Cir.), cert. denied, 454 U.S. 1031 (1981); *Whiting v. Dow Chemical Co.*, 523 F.2d 680 (2d Cir. 1975). The proposed definition, however, would go beyond most of the judicial decisions and state that an indirect pecuniary interest is sufficient to convey beneficial ownership.

power or investment power to make money for the user or immediate family members would satisfy the pecuniary standard of the proposed rule. Comment is solicited as to whether the right to receive dividends, without any other interest, should be sufficient to satisfy the standard.

b. *Derivative securities.* Under proposed Rule 16a-1(a)(2)(i), derivative securities, whether or not presently exercisable, would be deemed to carry a pecuniary interest in, and thus beneficial ownership of, the underlying securities for purposes of section 16. Insiders holding derivative securities are affected by the performance of the underlying securities and, therefore, have a pecuniary interest in those securities, even if the derivative securities are not presently exercisable.<sup>65</sup> The proposed rule expands current Rule 16a-6(b),<sup>66</sup> which attributes beneficial ownership in the underlying securities only to presently exercisable derivative securities.

c. *Family holdings.* The status of family holdings and transactions under section 16 has been the subject of many requests for interpretive advice and much litigation. The Commission has expressed the view that family holdings presumptively should be attributed to the insider. Enrichment of a family member living in the same household can benefit the insider by reducing the need or the potential need of the insider to lend or contribute funds to support the family member, or by increasing the family members' contributions to the support of the insider and the household.<sup>67</sup> The judicial decisions are mixed, but, in contrast to the Commission's position taken in releases, most hold that beneficial ownership need not be attributed to the insider where the financial independence of the family member can be shown.<sup>68</sup>

<sup>65</sup> For a complete discussion of the treatment of derivative securities, see Section IV, *infra*.

<sup>66</sup> 17 CFR 240.16a-6(b).

<sup>67</sup> "Absent countervailing facts, it is expected that securities held by a spouse, minor children and other relatives who share the same home as the insider will be reported as being beneficially owned by the insider since such relationships ordinarily result in the insider obtaining benefits substantially equivalent to ownership." Release 34-18114 Q.4.

<sup>68</sup> See *CBI Industries v. Horton*, 682 F.2d 643 (7th Cir. 1982) (no attribution for insider who was co-trustee for his adult sons, since he had no duty to support); *Whittaker v. Whittaker Corp.*, *supra* (invalid mother's holdings were attributed to insider because he had power of attorney, was her sole heir, and used her money for his benefit); *Whiting v. Dow Chemical Co.*, 523 F.2d 680 (2d Cir. 1975) (spouse's holdings were attributed because couple shared a joint investment plan); *Schur v. Salzman*, 365 F. Supp. 725, 732 (S.D.N.Y. 1975) (spouse's purchase was attributed because money came from joint account and there were no "special circumstances" to support claim that insider was

Proposed Rule 16a-1(a)(2)(ii) would codify the Commission's historic position, deeming an insider to be the beneficial owner of securities held by a member of the immediate family sharing the same residence.<sup>69</sup> The Commission recognizes the increasing prevalence of multi-career, multi-income families in which members of the family may have independent financial status. Nonetheless, the potential for abuse of family holdings calls for aggregation. The proposed definition focuses on family members in the same residence, who reasonably may be assumed to act in one degree or another as an economic unit, and who may benefit from each other's enrichment.

The definition would, however, deviate from the Commission's historic position in one respect in order to provide greater certainty. Instead of a presumption of attribution, the rule would uniformly and automatically attribute beneficial ownership for holdings of the immediate family. Comment, however, is solicited on whether the rule should provide that the attribution is a rebuttable presumption only.

The Commission also recognizes that in many circumstances people who are not family members may live together and form an economic unit. As an alternative to the proposed definition, the Commission is considering adopting a definition whereby insiders are deemed to be the beneficial owners of all holding held by "any person sharing the same residence, except for employees or tenants." Comment is solicited as to which alternative is preferable.

d. *Partnership holdings.* The holdings of a general partnership consistently have been attributed to the general partners, in proportion to their partnership interests, because they have a direct pecuniary interest in the holdings of their partnership.<sup>70</sup>

not beneficial owner); *Blau v. Potter*, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,115 (S.D.N.Y. 1973) (no attribution where spouse was financially independent, had separate accounts, and there was no control or input by insider); but see *Altamil Corp. v. Pryor*, 405 F.Supp. 1222 (S.D. Ind. 1975) (the only court to find that an indirect benefit of enriching spouse was sufficient; however, holding was questioned in *CBI Industries*).

<sup>69</sup> "Immediate family" would be defined in proposed Rule 16a-1(b).

<sup>70</sup> See, e.g., *Blau v. Lehman*, *supra*; Exchange Act Release No. 1965 (Dec. 21, 1938) [11 FR 10971]. In contrast, holdings generally have not been attributed to the individual shareholders of a corporate shareholder, except in situations involving closely held corporations. Release 34-18114 Q.8.

Proposed Rule 16a-1(a)(2)(iii) would codify the present interpretation of general partnership holdings.

In contrast, the general or limited partners of a limited partnership have only a limited indirect pecuniary interest in the holdings of the limited partnership and, by virtue of the operation of partnership law, limited partners have no right to control the partnership. General partners of a limited partnership have a measure of control over the limited partnership that is similar to that of a corporate director.<sup>71</sup> Under current interpretation and consistent with the treatment of the holdings of a corporate director, absent other circumstances, neither limited nor general partners of a limited partnership are treated as beneficial owners of the securities held by the entity. This interpretation would be retained. Comment is solicited as to whether a rule relating to limited partnership holdings, codifying or modifying present interpretation, is necessary. Additionally, comment is solicited as to whether a general partner of a limited partnership should be treated the same as a general partner in a general partnership. Commenters should provide reasons supporting their conclusion.

The Commission has determined not to propose a rule specifically addressing corporate holdings, to permit courts flexibility in applying the proposed pecuniary interest standard. Comment is solicited as to whether a rule is necessary and whether the determination as to attribution should be based upon the number of shareholders, or the percentage of voting stock they own.

e. *Dual ownership.* Where beneficial ownership is attributed to more than one person (e.g. family members, trusts, and beneficiaries), each beneficial owner may be required to report a securities transaction. This will arise, for example, where two members of the immediate family are insiders in their own right. Proposed Rule 16a-1(a)(3) would specify that both beneficial owners would report holdings and transactions. It would also state that the issuer could recover short-swing profits only once. The courts would decide how to apportion liability.

f. *Disclaiming Beneficial Ownership.* Proposed Rule 16a-1(a)(4) is similar to current Rule 16a-3,<sup>72</sup> which permits a

<sup>71</sup> See *Integrated Resources American Insured Mortgage Investors—Series 85* (March 25, 1986).

<sup>72</sup> This would not affect the ability of a person to disclaim beneficial ownership for purposes of section 13(d). See 17 CFR 240.13d-4.

person to declare that filing a statement does not equate to an admission that the person is the beneficial owner of the securities reported. Given the addition of the beneficial ownership definition, the proposed rule, unlike the current rule, would limit the ability to disclaim beneficial ownership to situations where beneficial ownership is not specified by rule.<sup>73</sup> Thus, for example, an insider could not disclaim beneficial ownership of securities held by a member of the immediate family.

#### 5. Trusts and Trustees

*a. Trustees.* A trust may become a ten percent holder of a class of equity securities, and therefore become an insider subject to section 16. The trustee generally makes the trust's investment decisions and administers the trust. Thus, when a trust becomes a ten percent holder, the trustee is required to file Forms 3 and 4 to report holdings and transactions on behalf of the trust. In addition, because the trust is a ten percent holder, the statute presumes that the trust, and therefore the trustee through whom the trust acts, has access to inside information. Trustees thus are treated as insiders in their own right and are required to report their personal transactions under current Rule 16a-8(c).<sup>74</sup>

No changes are proposed. The trust and the trustee would have separate reporting obligations for their respective transactions, so there is no duplicative reporting or liability. Thus, a trustee reports the transactions of the trust as agent of the trust and would not be personally responsible for short-swing profit derived by the trust. Trustees would be personally responsible only for profits realized with respect to securities deemed to be beneficially owned by them for reporting and profit recovery purposes.

The proposed rules would expand the current scheme to address situations where the trustee is an insider and the trust is not a ten percent beneficial owner.<sup>75</sup> If a trustee has access to inside information, this access should be attributed to the trust because of the substantial potential for the trust to benefit from the trustee's insider status. Thus, if an officer or director is selected to be a trustee of a friend's trust, that trust would be treated as an insider

because it has access to inside information through the trustee. Separate reporting responsibilities would result, as would separate liabilities. The trust would remain an insider until a non-insider trustee was appointed or the trustee ceased to be an insider.

Comment is requested as to whether trustees should become insiders if they administer more than one trust that collectively, but not individually, hold over ten percent. Under the proposed rule, the trustee, assuming the trustee exercises voting power or investment control, would be deemed to have beneficial ownership for purposes of section 13(d), and therefore the trustee would be a ten percent holder. Comment is requested as to whether this is an appropriate result in the case of professional trust companies such as banks. Do such institutions exercise their voting or disposition authority on a company-wide basis or is there a different voting policy applicable for each trust? Would exemptions from section 16(a) and/or (b) be appropriate for professional trust companies (such as banks), which administer numerous trusts in the ordinary course of business?

*b. Beneficiaries.* Beneficiaries of trusts rarely exercise voting or investment control over the securities held in trust. Therefore, trust beneficiaries have not been presumed to have access to material non-public information and have not historically been deemed insiders merely because the trust or the trustee is an insider. The revised rules would preserve this approach.

Where a trust's beneficiaries are insiders, they, as beneficial owners of the trust corpus, would be required to report trust transactions that are executed at their direction or with their approval as their own, in proportion to their beneficial interest, because they have a pecuniary interest in the trust holdings. Proposed Rule 16a-5(a)(4) continues this approach.<sup>76</sup> Thus, under certain circumstances, trust transactions on behalf of insider beneficiaries could be matched with other transactions inside or outside the trust to yield a short-swing profit.<sup>77</sup>

*c. Beneficial owners.* Where a settlor or trustee has a pecuniary interest in the trust holdings, beneficial ownership would be attributed to the settlor or trustee, just as to each other person with a pecuniary interest. Such situations are listed in proposed Rule 16a-5(a)(3) and current rule 16a-8(a).<sup>78</sup> There may be other situations where a settlor or trustee would have a pecuniary interest therefore, the proposed rule is not intended to be exclusive.

*d. Remote interests.* In contrast to the situations mentioned above, where additional persons are deemed beneficial owners of the trust holdings, there are situations where a beneficiary's pecuniary interest in a portfolio of securities held by a trust is so remote that attribution of beneficial ownership to the beneficiary is inappropriate. Proposed Rule 16a-5(d) would retain the exemptions for remote interests contained in current Rule 16a-8(g),<sup>79</sup> with one exception. The Commission proposes to delete the exemption for a business trust with over 25 beneficiaries because these entities operate similarly to a corporation and different treatment appears inappropriate.<sup>80</sup>

The proposed rule would exempt remainder interests in trusts as being too remote to convey beneficial ownership. This would be accomplished by redesignating and simplifying Rule 16a-8(f).<sup>81</sup> Whereas the current rule addresses only beneficial ownership for purposes of ten percent holder analysis, the proposed rule would expand the exemption for all purposes. The proposal would not exempt acquisitions of securities by a holder of a remainder interest upon the death of the prior beneficiary. However, comment is solicited as to whether such an exemption is appropriate and whether acquisitions upon the termination of trusts should be exempted under other specified circumstances when not predictable by or under the control of the remainder holder.

*e. Intra-trust exemption.* Current Rule 16a-8(b) provides a dual exemption for intra-trust transactions.<sup>82</sup> First, an exemption is provided for settlors or beneficiaries of a trust if less than 20 percent of the market value of the trust (as determined at the end of the preceding fiscal year) consists of the issuer's equity securities. Additionally, an exemption is provided for

<sup>73</sup> 17 CFR 240.16a-3. The language of the proposal is identical to the current rule, except that the last clause was added.

<sup>74</sup> 17 CFR 240.16a-8(c). The Rule would be renumbered Rule 16a-5(a)(1), and the language would be amended to conform to the statutory standard of more than ten percent beneficial ownership.

<sup>75</sup> See Proposed Rule 16a-5(a)(2).

<sup>76</sup> This is in accord with current practice. See Rule 16a-8(a)(2) [17 CFR 240.16a-8(a)(2)]. See also proposed Rule 16a-8; Section III.A.5.e., *infra*.

<sup>77</sup> For example, if a beneficiary directs the trustee to buy 1,000 shares of stock, the beneficiary would report (and be responsible for any short-swing profits derived from) his share of the securities purchased.

<sup>78</sup> 17 CFR 240.16a-8(a).

<sup>79</sup> 17 CFR 240.16a-8(g).

<sup>80</sup> See 17 CFR 240.16a-8(g)(4).

<sup>81</sup> 17 CFR 240.16a-8(f).

<sup>82</sup> 17 CFR 240.16a-8(b).

transactions made without prior approval of the insider.

Proposed Rule 16a-3 would eliminate the Rule 16a-8(b) exemption for trusts with less than 20 percent of their market value in securities of the registrant. The 20 percent ceiling is not consistent with the purposes underlying section 16, because it permits settlors and beneficiaries total discretion. In recent years there has been an increase in the number of plans in trust form that provide insiders with a choice of investment vehicles (such as company stock, government securities, and mutual funds) within the same plan. The company stock portion of the plan may account for less than 20 percent of the value securities in the trust, but the determination to move funds into or out of company stock is an investment decision that could be made while in possession of material non-public information and result in significant profits.

Unlike the 20 percent of market value exemption, the Commission would retain the Rule 16a-8(b) exemption for intra-trust transactions made without the prior approval of the insider. Where an insider does not direct or approve a transaction, there is a commensurate lack of opportunity to abuse inside information. To clarify the intended result, the proposed Rule would add the words "or direction" after the words "prior approval." Comment is solicited as to whether the proposed exemption should be further conditioned upon a beneficiary's lack of consultation with the trustee concerning the transaction.

#### B. How and When To Report

Proposed Rule 16a-3 would combine all current rules that state how, what, when, and where to file. As discussed below, there are three significant changes from the current rules: (1) Insiders would be required to forward a copy of each filing to the issuer; (2) reporting of exempt transactions would be deferred; and (3) a new annual filing requirement would be added.

##### 1. Copies to Issuer

Proposed Rule 16a-3(e) would require insiders to forward copies of Forms 3, 4 and 5 to the issuer's corporate secretary or other person designated to receive such reports at the same time that a report is forwarded to the Commission for filing.<sup>83</sup> This new requirement would

be added to encourage compliance with the reporting requirements of section 16(a). It would enable issuers to monitor filings more effectively and to assist insiders in meeting their reporting obligations. Comment is solicited on whether the rule should specify the method of furnishing this copy (e.g., by delivery at the issuer's offices, by registered or certified mail, or by first class mail) or require that the copy be furnished by a means reasonably calculated to reach the issuer by the date on which the Form 3, 4 or 5 is due at the Commission.

##### 2. Reporting Exclusions

Under the current rules, some transactions (such as intra-trust transactions) are exempted from reporting, by virtue of a rule pursuant to section 16(a), and thus from the short-swing profit recovery provisions of section 16(b). In contrast, other types of transactions (such as employee benefit plan awards) are exempted from section 16(b) short-swing profit recovery but must be reported at the same time as is required for a non-exempt transaction. The proposed rules would change the current dichotomy between reportable and non-reportable transactions to a three-part classification: transactions exempt from section 16, transactions required to be reported on a current basis, and transactions required to be reported in an annual filing.

Certain transactions are beyond the control of the insider or are part of the ordinary course of a legitimate business. Where the disclosure of such transactions would not further the purposes of section 16(a)—to provide shareholders with a mechanism to monitor insider transactions for possible short-swing profit recovery, and to provide investors with a possible indication of the insider's view concerning the prospects of the company—it is appropriate to exclude them from section 16(a) reporting. The proposed rules would contain five such exclusions: (1) A temporary 12 month exclusion for fiduciaries that are liquidating estates;<sup>84</sup> (2) transactions involving remote and indirect interests, such as remainder interests in trusts, indirect interests in a portfolio of securities held by designated companies or pension plans;<sup>85</sup> (3) transactions by

an underwriter relating to a distribution of securities;<sup>86</sup> (4) intra-trust transactions conducted without the prior approval of the insider;<sup>87</sup> and (5) odd-lot trades by odd-lot dealers.<sup>88</sup>

The first exclusion relates to fiduciaries such as executors and trustees in bankruptcy. Trades by these persons, where conducted to liquidate an estate holding ten percent of a class of equity securities, will in effect end insider status. They perform a useful service for purposes of probate. Generally, requiring reports of such trades would serve no section 16 purpose.

The same is true for remote interests. For example, disclosure of the fact that an insider owns shares in a mutual fund that holds some stock of the insider's company serves no section 16 purpose because the transactions do not reflect the insider's view of the company's prospects and are not likely to involve abuse of inside information. It is not the insider who makes the investment decision. The same is true for contingent interests and holdings in retirement plans.

Distributions by underwriters and selling group dealers would be excluded for reasons similar to those supporting exclusion of transactions by liquidating agents. Underwriters and selling group dealers are conduits for securities in a distribution and their ownership is generally brief. Although they may have access to inside information in some cases, their market activity generally is constrained by other rules.<sup>89</sup> As long as they act in those capacities, rather than as investors, there is no need for a report.

Insiders that are beneficiaries of a trust sometimes have little or no control over transactions conducted by the trustee, but could be subjected to short-swing profit recovery because of the trustee's trading decisions. Where the insider has no prior opportunity to approve or direct the transactions, reporting is not necessary, and no liability is appropriate. As with the current rule, the exemption would apply

<sup>83</sup> Proposed Rule 16a-7 would retain the exemption of current Rule 16b-2 [17 CFR 240.16b-2], but would delete the requirement that insider underwriters participate equally with non-insider underwriters.

<sup>84</sup> Proposed Rule 16a-8 would retain part of the exemption contained in current Rule 16a-8(b). See Section III.A.5.e., *supra*.

<sup>85</sup> Proposed Rule 16a-9 would retain current Rule 16a-5 [17 CFR 240.16a-5] without change. An "odd-lot" is generally a quantity of stock less than 100 shares.

<sup>86</sup> See, e.g., Rule 10b-6 [17 CFR 240.10b-6]. Note that the term "distribution" has different meanings under sections 10 and 16.

<sup>83</sup> Such a filing requirement is similar to other Exchange Act rules requiring copies of forms to be sent to the registrant. E.g., Rules 13d-1(a), 13d-2(a), and 14d-3(a)(2) [17 CFR 240.13d-1(a); 17 CFR 240.13d-2(a); 17 CFR 240.14d-3(a)(2)].

<sup>84</sup> Proposed Rule 16a-5(b) would retain, with minor language changes, the exemption contained in current Rule 16a-4 [17 CFR 240.16a-4].

<sup>85</sup> Proposed Rule 16a-5(d) would retain the beneficial ownership exclusions of current Rule 16a-8 (f) and (g). See Section III.A.5.d., *supra*.

to only intra-trust transactions and not to distributions from a trust.

Finally, the reporting exclusion for odd-lot dealers would be retained, because odd-lot prices are tied to the market price of round lot transactions,<sup>90</sup> and odd-lot dealers may engage in hundreds of trades in one day. Disclosure would be both time-consuming and unnecessary for shareholders and investors.

Current Rule 16a-11<sup>91</sup> provides a reporting exclusion for Dividend Reinvestment and Interest Plans ("DRIPs"). The provisions dealing with DRIPs would be moved to proposed Rule 16b-9 and the reporting exclusion would no longer be provided. While DRIPs generally are unlikely vehicles for abuse, shareholders and investors have an interest in monitoring insiders' total holdings. Reporting on an annual basis, as proposed, would not be unduly burdensome.

### 3. Reported Transactions

Under the present reporting scheme, virtually all transactions not exempted under section 16(a) must be reported in a current manner, regardless of whether the trades are exempt from short-swing profit recovery under section 16(b). The only exception is deferred reporting relating to small acquisitions.<sup>92</sup> Reporting of such acquisitions is deferred until the purchases exceed \$10,000 or the next regular Form 4 is required to be filed, whichever occurs first.

The Commission proposes to amend the rules to permit annual reporting of transactions exempt from section 16(b) liability, including those involving stock splits, dividends, gifts, and specified small acquisitions. The current report on Form 4 will be reserved for the acquisitions and dispositions that have greater potential either for revealing the insider's assessment of the company or for abuse of inside information.

Proposed Rule 16a-3(f) would require that transactions entitled to annual reporting be reported on a new Form 5, which would be required to be filed on or before the thirtieth day after the end of the issuer's fiscal year. Reporting persons also would be required to disclose on Form 5 all transactions during the fiscal year that should have been, but were not, reported at an earlier time on Form 4, and their total

beneficial holdings of equity securities of the issuer as of year end. If there were no reportable transactions during the fiscal year, the form would be submitted with such a notation. In addition to filing the Form 5 with the Commission, the insider would have to provide the report to the designated exchange as well as the issuer.

The small acquisition reporting deferral would be modified to reflect the addition of the annual Form 5 filing. Under that proposal, reporting would be deferred until the earliest of the filing of the next Form 4, the filing of the next Form 5, or the cumulative acquisition in excess of \$10,000.

Form 5 would enable interested parties to compare the year-end holdings of reporting persons with their Form 4 reports filed during the year, and to identify and explain discrepancies. The Form would provide a mechanism for reporting events such as gifts and dividends.<sup>93</sup> The annual reporting requirement, as opposed to a reporting exemption, also would provide interested parties with the opportunity to challenge reporting persons' claims to exemptions.

The requirement to file an annual report on holdings on Form 5, regardless of whether the reporting person had traded during the year, should aid compliance with section 16(a) by compelling insiders to review their transactions annually. In addition, the Form 5 filing requirement would enhance the Commission's ability to identify non-reporting insiders.<sup>94</sup>

The proposed filing period, 30 days following the end of the registrant's fiscal year, is intended to provide the issuer with a copy of the report to use in the preparation of its Form 10-K annual report and annual proxy statement. As discussed in section VIII of this Release, the Commission is proposing to require annual disclosure by issuers of those insiders who have been delinquent in compliance with the reporting requirements under section 16(a). The registrant would be entitled to rely upon the disclosures made in Forms 3, 4, and 5 filings. The Commission requests comment on the practicality of the 30 day period to file the Form 5; should it be shorter (e.g., 15 days) or longer (e.g., 45 or 60 days)? If the period were extended, would the issuers still be able to use the forms as the basis for

determining insider reporting delinquencies that must be disclosed in the Form 10-K or proxy statement? If not, commenters should address what other obligation of inquiry could be placed on the issuer to document the disclosure required as to delinquent filers.

Several minor changes are also proposed. Paragraphs (a) and (b) of proposed Rule 16a-3 would be almost identical to current paragraphs (a) and (b) of Rule 16a-1. Current Rule 16a-1(a) requires that initial statements of ownership be filed on Form 3 and subsequent changes in beneficial ownership be filed on Form 4. As proposed, new paragraph (a) also would require that an annual statement be filed on Form 5. Current Rule 16a-1(b) states that another Form 3 is not required when a class of equity securities is registered if another class of the issuer's securities already is registered under section 12, or if an insider assumes an additional relationship with the issuer. This rule would be retained.

Proposed Rule 16a-3(c) would be similar to current 16a-1(c). Section 16(a) requires all reports pursuant to the Section to be filed not only with the Commission, but also with any exchange on which the registrant's securities are traded. The current rule permits issuers that are listed on more than one exchange to designate one exchange as the sole exchange to receive copies of its insiders' Forms 3 and 4. No changes are proposed, but the requirement to file reports with exchanges would be extended to Form 5 as well.

Proposed Rule 16a-3(d) would be identical to current Rule 16a-7<sup>95</sup> which requires only a single filing for compliance with sections 16(a), 17(a) of the Public Utility Holding Company Act, and 30(f) of the Investment Company Act.

### 4. Date of Filing

A new Rule 16a-3(g) is proposed, which would state that, as is currently the case, the date of filing is the date on which a Form 3, 4 or 5 is received at the Commission,<sup>96</sup> but add a proviso that would in some cases permit reliance on having transmitted the filing to the Commission. The proviso would deem a Form timely filed, even if not received by the due date, if the filer established that the Form was transmitted on or before the due date by first class mail or equally prompt means. The burden of proof would be on the filer. This change

<sup>90</sup> A round lot is generally 100 shares of stock.

<sup>91</sup> 17 CFR 240.16a-11.

<sup>92</sup> As modified, the reporting deferral for small acquisitions in current Rule 16a-9 [17 CFR 240.16a-9] would be retained as proposed Rule 16a-6. This rule is not an exemption from Section 16(b) liability; thus, it is more appropriate to place the rule under section 16(a).

<sup>93</sup> Stock splits and stock dividends are not generally viewed as purchases in that there is no change in the percentage of ownership. Nonetheless, the increase in the number of shares needs to be explained.

<sup>94</sup> See Section VIII, *infra*, for a discussion of section 16(a) compliance.

<sup>95</sup> 17 CFR 240.16a-7.

<sup>96</sup> See Exchange Act Rule 0-3 [17 CFR 240.0-3].

would make it less likely that insiders be in non-compliance with the reporting requirements as a result of delays in the mail. It also would provide a small amount of additional time for insiders to prepare their filings, as the mailing could take place on the due date. Comment is solicited on this approach.

#### IV. Derivative Securities

Much of the current treatment of derivative securities under section 16 has been left to court interpretation, and the results have been inconsistent. The proposed rules are intended to provide a comprehensive framework for the treatment of derivative securities and specifically address a number of common interpretive issues. Under the proposal, the Commission would treat derivative securities as indirect ownership of the underlying equity securities.

Derivative securities would be defined in proposed Rule 16a-1(c) to include options,<sup>97</sup> warrants, stock appreciation rights ("SARs"), convertible securities, and similar rights related to an equity security. As proposed, the definition of derivative securities excludes securities issued pursuant to an employee benefit plan qualifying under Rule 16b-3 that must be settled in cash ("cash-only"), all broad-based index options, and broad-based index futures. Transactions involving such instruments thus would not be subject to section 16(a) or (b).

Cash-only derivative securities that are not standardized and are awarded as part of an employee benefit plan are similar to cash bonuses, rather than equity securities. The Commission solicits comment on whether derivative securities that provide a choice between cash or stock should likewise be excluded from section 16, if the insider does not in fact choose which form of compensation to receive.

Broad-based index options and index futures are not susceptible to the types of abuses addressed by section 16.<sup>98</sup> Such options and futures relate to a large number of component securities. As a result, the interest in any one component security is so small that the holder of the option or future should not be deemed the beneficial owner of the component securities for Section 16 purposes. The exemption, however, would not extend to options on narrow-based indices where one issuer may account for a substantial amount of the

index weighing and, therefore, a movement in the price of a component stock would result in a similar move in the index.<sup>99</sup>

In addition to a proposed definition of derivative security, the Commission proposes to define the terms "call equivalent position" and "put equivalent position." Proposed Rule 16a-1(d) would define call equivalent position to mean a derivative security position that increases in value as the underlying equity security increases in value (e.g. long call options, long warrants, long convertible securities, and short put options). Proposed Rule 16a-1(e) would define put equivalent position to mean a derivative security position that increases in value as the underlying equity security decreases in value (e.g. long put options and short call options).

#### A. Reporting

##### 1. Acquisitions

The current rules require that an insider file a Form 4 to report an acquisition of securities when derivative securities held by that person become exercisable.<sup>100</sup> Proposed Rule 16a-4(a) would change the current reporting scheme by requiring that derivative securities be reported upon their grant or acquisition, regardless of when they are exercisable. Only the derivative security would be reported, rather than the underlying security to which it relates. Thus, the purchase for purposes of section 16 would occur at grant or acquisition.<sup>101</sup>

The Commission is proposing this change for three reasons. First, the investment is made when the derivative securities are acquired, and it is possible to realize a profit from derivative securities that are transferable even if not yet exercisable.<sup>102</sup> The insiders are at risk of price fluctuation from the time of acquisition, even before the derivative security becomes exercisable. If the value of the underlying stock increases, the value of a call equivalent position increases and that of a put equivalent position decreases, notwithstanding the fact that the derivative security may not yet be exercisable. Under the current

rules, an insider could both purchase and sell a derivative security that is not yet exercisable, realize a short-swing profit, and yet never have to report the transactions (nor be responsible for short-swing profits pursuant to section 16(b)).

Second, under the current scheme, profit recovery can include long-term appreciation from holding non-exercisable derivative securities. By calculating the holding period as beginning on the date of acquisition or disposition, rather than the date of exercise, this will no longer be the case.<sup>103</sup>

The third benefit of changing the period is that it is more likely that reporting persons will remember to report the transaction at acquisition, while they may forget to do so when a derivative security becomes exercisable days, months, or years later. Thus, the proposed change should aid section 16(a) compliance by decreasing the number of reporting delinquencies due to oversight.

##### 2. Exercises and Conversions

Presently, all exercises and conversions of derivative securities must be reported on a current basis on Form 4, as they are viewed as dispositions of the derivative securities and acquisitions of the underlying securities. Under proposed rule 16a-4(b), an exercise or conversion of or against a call equivalent position would continue to be treated by the person who had held that position as a closing of the derivative security and an acquisition of the underlying security for reporting purposes. An exercise of or against a put equivalent position would be treated by the person who had held that position as a closing of the derivative security and a disposition of the underlying security. Any exercise or conversion exempted from short-swing profit liability by operation of proposed rule 16b-6,<sup>104</sup> however, could be reported on an annual basis pursuant to proposed Rule 16a-3(f). This is consistent with the proposed approach of permitting exemption transactions to be reported annually. Any exercise or conversion not exempted from section 16(b) would be required to be reported currently on Form 4. Comment is solicited as to

<sup>97</sup> Under the Commodities Exchange Act section 2(a)(1)(B) [7 U.S.C. 2a(ii) (1982)], futures on such narrow-based indices are effectively precluded. See Exchange Act Release No. 20578 (Jan. 18, 1984) [49 FR 2884].

<sup>100</sup> See 17 CFR 240.16a-6(a).

<sup>101</sup> This would be true for all options, including employer granted options. No court has deemed an employer grant the equivalent of a purchase. Most employer granted options, however, would be exempt acquisitions, if granted pursuant to a plan meeting the conditions of rule 16b-3.

<sup>102</sup> For example, some warrants may not be exercisable for a year after issue, yet independent markets may develop for trading these warrants.

<sup>103</sup> For example, under the current rules, a person may receive an option that is not exercisable for five years. During that five years, the value of the option may increase significantly, yet currently it will not be deemed to be purchased until it becomes exercisable. As a result, another six month holding period is required before sale of the securities to avoid short-swing profit recovery.

<sup>104</sup> See discussion in Section IV.B.2, *infra*.

<sup>98</sup> Both standardized and non-standardized options would be included.

<sup>99</sup> The Commission determines whether an index is broad or narrow-based when it approves the option for trading. See, e.g., Exchange Act Release No. 21032 (June 8, 1984) [49 FR 24964].

whether an exercise or conversion of a derivative security should be reported currently on a Form 4, even though the acquisition or disposition of underlying stock may be exempt from section 16(b).

### 3. Dispositions

Currently, dispositions of derivative securities through sale, exercise, conversion, expiration, surrender, or cancellation are considered reportable events.<sup>105</sup> The writing of an option constitutes a sale. Under proposed Rule 16a-4(a), dispositions of derivative securities that involve sales would continue to be reported on a current basis on Form 4. Dispositions not involving sales (e.g., exercises, conversions, gifts, and expirations of long derivative securities positions) would be exempted from section 16(b)<sup>106</sup> and would be eligible for annual reporting on Form 5. Expirations of long derivative securities positions cannot result in a short-swing profit and so are impliedly exempt from section 16(b); thus, they are reported on Form 5. Expirations of short derivative securities positions, however, may result in short-swing profit and should be reported on Form 4.

### 4. Put Options

Unlike the current rules under section 16, the proposed rules specifically address the treatment of put options. The acquisition of a put option would be reported on Form 4 as the acquisition of a derivative security. For purposes of sections 16(b) and (c), however, it would also be treated as the sale of the underlying security. When the exercise of a put option is exempt from section 16(b) under proposed Rule 16b-6(b), the transaction would be reported on the annual Form 5; otherwise, it would be reported currently on Form 4. The cancellation or expiration of a long put option would be reported in a manner similar to the cancellation or expiration of a long call option.<sup>107</sup> The writing of a put option would be treated as a call equivalent position (just as the writing of a call option would be treated as a put equivalent position).

### B. Short-Swing Profit Recovery

The current rules under section 16 do not address the issue of section 16(b) liability for transactions in derivative securities. When the Commission adopted current Rule 16a-2(b), it specifically declined to decide whether transactions in derivative securities could give rise to an action for short-

swing profit recovery. It chose instead to leave the decision to the courts.<sup>108</sup> The courts, however, have not provided definitive guidance in the area. Some cases have found that an option does not confer beneficial ownership of the underlying security for purposes of section 16(b) until exercised, unless the down payment is so large that an exercise is compelled economically,<sup>109</sup> or unless the option conveys significant rights of ownership (such as voting power).<sup>110</sup> In contrast, other cases have stated that derivative securities do convey beneficial ownership of the underlying security.<sup>111</sup>

### 1. Acquisitions

The proposed rules would treat the acquisition or disposition of a derivative security as a transaction in the underlying security for section 16(b) purposes. Thus, for example, a purchase of a call option could be matched with a sale of convertible preferred stock, if they both shared the same class of underlying equity security. In general, the acquisition or disposition of the underlying security through exercise would be viewed as an exempt transaction, as discussed below.

The determination as to whether a transaction should be subject to short-swing profit recovery is based upon profit potential and the opportunity for abuse of inside information. Derivative securities clearly provide such opportunity for abuse and have figured largely in a number of the Commission's insider trading cases.<sup>112</sup> Indeed, the opportunity for profit is usually magnified through the use of derivative securities because the leverage involved allows a substantially greater profit opportunity.

There is little economic difference between the potential for abuse of inside information by the combined trading of underlying securities and derivative securities, as opposed to trading just one type of security, and the

distinction drawn in some cases does not further the purposes of section 16.<sup>113</sup> For example, an insider might purchase a call option, instead of stock, to take advantage of favorable inside information. If the insider were to sell stock within six months, a short-swing profit would be realized. Under the current rules, it is uncertain that a court would order recovery of such profit.

### 2. Exercises and Conversions

Currently, exercises and conversions of derivative securities are treated differently, for purposes of section 16(b), even though they are substantially similar in effect. In the case of call equivalent positions, both exercises and conversions entail a closing of a derivative security and a simultaneous acquisition of the underlying security. Exercises of put equivalent positions entail a disposition of a derivative security and a simultaneous disposition of the underlying security. An exercise generally is accompanied by a payment of cash equal to the strike price, whereas a conversion usually does not involve a cash payment. While current case law exempts the disposition of the derivative security from section 16(b) for both exercises and conversions,<sup>114</sup> the acquisition of the underlying security has been treated differently. Apparently because there generally is no cash paid in a conversion, the courts have treated the acquisition of the underlying security through a conversion as an exempt transaction, while exercise of an option is treated as a non-exempt acquisition.<sup>115</sup>

The current rules encourage insiders to change the form, rather than the substance, of transactions to avoid short-swing profit liability. A few examples illustrate the problem:

(1) Insider A is granted a stock option pursuant to an employee benefit plan of the registrant, while Insider B is granted stock (rather than an option) pursuant to another benefit plan of the registrant. Five years later, both insiders decide it is time to sell their stock for personal

<sup>108</sup> Exchange Act Release No. 8325 (June 6, 1968) [33 FR 8774].

<sup>109</sup> E.g., *Bershad v. McDonough*, 428 F.2d 693 (7th Cir. 1970).

<sup>110</sup> See *Colan v. Monumental Corp.*, 713 F.2d 330 (7th Cir. 1983); *Newman v. RKO General, Inc.*, 425 F.2d 348 (2d Cir.), cert. denied, 400 U.S. 854 (1970).

<sup>111</sup> See *Gund v. First Florida Banks, Inc.*, 726 F.2d 682 (11th Cir. 1984) [sale of convertible debentures may be matched with purchase of underlying stock]; *Seinfeld v. Hospital Corp. of America*, 685 F.Supp. 1057 (N.D. Ill. 1988) [acquisition of option should be matched with sale of underlying stock].

<sup>112</sup> A number of cases brought by the Commission for insider trading have involved derivative securities. See, e.g., *SEC v. Tome*, 833 F.2d 1086 (2d Cir. 1987); *SEC v. Collier*, Litigation Release No. 11817 (July 26, 1988); *SEC v. Certain Unknown Purchasers, et al.*, Litigation Release No. 11012 (Feb. 26, 1986).

<sup>113</sup> See, e.g., *Morales v. Mapco, Inc.*, 541 F.2d 233 (10th Cir. 1976); *Silverman v. Landa*, 306 F.2d 422 (2d Cir. 1962). These judicial decisions did not match a transaction in a derivative security with a transaction in the underlying security.

<sup>114</sup> See, e.g., *Blau v. Lamb*, 363 F.2d 507 (2d Cir. 1966), cert. denied, 385 U.S. 1002 (1967) [conversions]; *Blau v. Ogsbury*, 210 F.2d 426 (2d Cir. 1954) [exercises].

<sup>115</sup> E.g., *Blau v. Lamb*, supra; *Ferraiolo v. Newman*, 259 F.2d 342 (6th Cir. 1958), cert. denied, 359 U.S. 927 (1959). Current Rule 16b-9 [17 CFR 240.16b-9] exempts only conversions where 15 percent or less of the market value of the securities acquired is paid as part of the exercise of the derivative security.

<sup>105</sup> See current Rule 16a-6(a).

<sup>106</sup> See Section IV.B.3., infra.

<sup>107</sup> See Section IV.A.3., supra.

reasons. Insider A exercises the option and sells the stock received from the plan. Insider A is subject to short-swing profit recovery<sup>116</sup> and may be compelled to disgorge much of the profit derived from the five year accretion in value of the underlying stock. Insider B, absent a separate purchase of stock, is not subject to shortswing profit recovery and may keep the resulting profit.

(2) An insider owns 1000 shares of stock and decides to purchase a call option that is exercisable into 100 shares of stock. Two months later, the insider sells 200 shares of stock. One month after the sale, the insider decides to exercise the call option as it is about to expire. The insider exercises the option and keeps the 100 shares received. This insider might be found responsible for two short-swing trades of 100 shares each, even though the insider actually purchased only 100 shares of stock.<sup>117</sup> Thus, the insider might be subjected to double recovery because the current rules would find two purchases of an equity security from one derivative security.<sup>118</sup>

(3) Two insiders purchase warrants and seven months later want to realize the profit. The insider who exercises the warrant and sells the underlying stock that is received, is subject to short-swing profit recovery. The insider who sells the warrant to someone else (for the same amount of profit) is not subject to short-swing profit recovery.<sup>119</sup>

The Commission proposes a significant departure from most of the current case law concerning exercises and conversions. Proposed Rule 16b-6(b) would treat exercises and conversions identically, since they operate in a like manner.<sup>120</sup> Both

exercises and conversions of in-the-money<sup>121</sup> derivative securities would be deemed purchases of the underlying securities exempt from section 16(b), because they merely change from indirect to direct the nature of the beneficial ownership in the underlying stock, without causing any change in the potential for profit. Exempting the conversion and exercise also appears appropriate since any profit is realized at the time the underlying securities are sold for cash or its equivalent.<sup>122</sup>

The proposed rules would resolve each of the problems illustrated above. Although there would be two purchases (a purchase at acquisition or grant of the derivative security and a purchase at exercise) for reporting purposes, the purchase incident to an exercise of an in-the-money derivative security would be exempt from the short-swing profit recovery provisions of section 16(b).<sup>123</sup> An insider could purchase a call option, exercise it at any time, and sell the underlying stock without being subject to recovery, if the sale occurred at least six months after the initial purchase of the call option.

Current Rule 16b-6 was intended to limit the profit recoverable from the exercise of a long-term option. It provides that a price not lower than the lowest stock price within six months (before or after) the date of sale shall be deemed the purchase price. Thus, an insider exercising an option held over six months would have the purchase price equal to either the strike price or the lowest stock price within six months of the sale, whichever resulted in the least profit. The proposed exemption for exercises renders current Rule 16b-6 unnecessary. Accordingly, current Rule 16b-6 is proposed to be rescinded.

As drafted, proposed Rule 16b-6(b) would not exempt exercises of out-of-the-money derivative securities. There appear to be few, if any, legitimate

reasons for such exercises. Convertible securities, however, would not be subject to this limitation because most convertible securities trade at a premium over the underlying securities and otherwise would be viewed as being out-of-the-money.

The Commission requests comment on the appropriateness of extending the exemption to include out-of-the-money derivative securities. Those favoring such an extension should address specifically those instances where such exercises could be legitimately expected. The Commission requests comment on any additional limitations on the exemption that would be appropriate.

### 3. Dispositions

a. *Background.* As discussed above, acquisitions of derivative securities would be deemed to convey beneficial ownership in the underlying securities. A decrease in or liquidation of a call equivalent position could be matched with either an acquisition of the underlying security or an increased put equivalent position exercisable for the same underlying equity security.<sup>124</sup>

There are several different types of dispositions of derivative securities: sales, exercises or conversions, expirations, and cancellations. As proposed, if an insider sells a derivative security such as a call option, warrant, or convertible security, that transaction could be matched with a purchase of another derivative or the underlying security for short-swing liability. If a derivative security were disposed of through an exercise or conversion, the disposition of the derivative security generally would be exempt from short-swing profit recovery by operation of proposed Rule 16b-6(b). In most cases, expirations of a long position in a derivative instrument cannot result in short-swing profits. However, in the case of an expiration of a short option position, the expiration would be treated as the purchase of the option because there is short-swing profit potential in such a case.<sup>125</sup> Cancellations generally would not be considered sales where the option issuer paid no compensation to the holder. The issuer's replacement of the cancelled security with a comparable derivative security would be viewed as a redemption of the old

<sup>116</sup> The exercise of the option would be deemed a purchase of the underlying stock, followed by an immediate sale of that same stock.

<sup>117</sup> The purchase of the option might be matched with the sale of the first 100 shares (see *Gund v. First Florida Banks, Inc.*, 726 F.2d 682 (11th Cir. 1984)), and the exercise of the option would be deemed another purchase, but of the underlying stock that could be matched with the other 100 shares sold.

<sup>118</sup> While a court has yet to address the double recovery issue, it is doubtful that such a recovery would be permitted. The example, however, illustrates the problem with the current scheme.

<sup>119</sup> See *Portnoy v. Seligman & Latz, Inc.*, 516 F. Supp. 1188 (S.D.N.Y. 1981).

<sup>120</sup> See *Seinfeld v. Hospital Corp. of America*, supra, where the court stated: "The courts have strayed because they have viewed the intervening event—the exercise of the option for stock—as an independent purchase. This is incorrect. Because the option holder already owns the right to purchase the stock at a fixed price, his decision to actually exercise the option does not provide him the ability to earn insider profits and thus does not constitute a section (b) 'purchase'." 685 F. Supp. at 1068.

<sup>121</sup> When the exercise price for a derivative security is less attractive than the market price (higher in the case of call options or lower in the case of put options), the option is considered out-of-the-money. If the exercise price and market price are the same, the option would be considered at-the-money and if the exercise price is more attractive than the market price, the option would be considered in-the-money.

<sup>122</sup> The Internal Revenue Service, in certain cases, considers an exercise as a taxable event (see IRC §§ 83(b), 421-425 (1986)); however, the purposes of section 16 are different from the purposes of the tax code. See *Greene v. Dietz*, 247 F.2d 689, 694 upon securities transactions is irrelevant to the Commission's determination to exempt a type of transaction).

<sup>123</sup> Two purchases, one of the option and one of the underlying security, would be reported so that shareholders could monitor the insider's actual holdings, even if the reporting was deferred to the annual Form 5.

<sup>124</sup> This would include derivative securities that are exercisable or convertible into other derivative securities that are, in turn, exercisable for the same underlying security.

<sup>125</sup> For example, an insider writes—that is, sells—a standardized call option for \$2 per share. Three months later it expires worthless and the insider profits the full \$2 per share.

security and issuance of a new security and would not be exempt, unless satisfying the exemption for redemptions in proposed Rule 16b-4.<sup>126</sup> An extension of a derivative security that is about to expire would be viewed similarly. Comment is solicited on whether the proposed treatment of extensions of derivative instruments would affect the considerations under which such extensions commonly are made.

A grant of an option may be viewed as a sale of the derivative security by the writer of the option, if consideration is received for the option. The courts have stated generally that writing an option is not a sale unless an exercise of the option is compelled economically through a sufficiently large downpayment.<sup>127</sup> However, that analysis has evolved in the context of viewing the exercise of options as an acquisition or disposition subject to section 16(b) liability. Given the theory underlying the proposed rules, that transactions in the derivative securities generally should be viewed for Section 16 purposes as proxies for transactions in the underlying securities, the proposed rules would treat the writing of a put or call option as an acquisition or disposition of the underlying security subject to section 16(b).

b. *Determination of profit.* As a result of the proposed treatment of derivative securities, there will be short-swing purchases and sales involving both derivative securities and underlying securities or two different types of derivative securities. For ease of administration, the Commission is proposing alternative rules to assist courts in calculating short-swing profits in such cases.

The Commission recognizes that the measurement of short-swing profits in transactions involving derivative securities can be a source of substantial confusion and complexity in actions brought pursuant to section 16(b). The difficulty in assessing short-swing profits in transactions involving derivative securities arises from two distinct sources.

First, section 16(b) of the Act specifically provides for recovery of short-swing profits "realized" by an insider "from any purchase or sale, or sale and purchase, of any equity

security of such issuer." Thus, if an insider realizes profits from a transaction involving derivative securities, but that profit is not attributable to changes in the price of the underlying equity, then it can be argued that those short-swing profits should not be subject to recovery under section 16(b).

For example, suppose an insider purchases a convertible instrument on January 1 when the price of the underlying security is \$50 per share. The price of the underlying equity remains at \$50 for all of January. By February 1, however, interest rates decline sharply and the insider sells the convertible at a profit. The profit realized by the insider in this transaction appears to be attributable to changes in interest rates, and not to changes in equity prices that could be related to the sort of insider abuse that Congress intended to prevent through the adoption of section 16(b). Accordingly, it could be argued that profit recovery techniques applied in transactions involving derivative securities should ideally separate profits attributable to changes in the price of the underlying equity from profits attributable to changes in interest rates or other factors.

The second source of difficulty in calculating damages in short-swing transactions involving derivative securities arises from the inherent complexity of these instruments. For example, the value of a call option depends on the price of the underlying stock, the exercise price of the option, prevailing interest rates, the option's time to expiration, and the volatility of the underlying equity.<sup>128</sup> Even if there is no change in the price or volatility of the underlying equity, the value of the option will change simply because the time to expiration changes or because interest rates change. Instruments that are more complex than a straightforward call option will be correspondingly more difficult to value. For example, the value of convertible bonds and convertible preferred stocks contains a fixed income component that is priced like a bond and a warrant or option on the underlying equity.<sup>129</sup> It could be argued that a short-swing profit rule should focus on the profits earned from the warrant or optionlike component of such an instrument and separate out profits attributable to changes in the value of the bond-like component.

Substantial progress has been made in the valuation of options and derivative instruments, and techniques such as the Black-Scholes option valuation formula and its progeny are now widely used by traders in the marketplace.<sup>130</sup> Indeed, many traders who rely on these rather intricate mathematical formulas are not mathematically sophisticated and "are not for the most part trained in the formula's mathematical derivation; they just use a specially programmed calculator or set of tables to find the value of [an] option."<sup>131</sup>

The Commission recognizes, however, that the interests of precision must be balanced against the costs of computation. The interests of justice and Congress' purpose in adopting section 16(b) will not be served by turning every case involving derivative instruments into a battle of experts over competing models of option valuation. Accordingly, the Commission seeks to provide certain benchmarks or rules of thumb to be applied in short-swing transactions involving derivative securities. These benchmarks, or rules of thumb, are not meant to preclude reliance on more detailed evaluation techniques when circumstances warrant.

Under Alternative A, proposed Rule 16b-6(d)(1) would provide a benchmark measure of recovery in relatively simple transactions involving purchases and sales of the same derivative instrument (e.g., the purchase and sale of call options with identical strike prices and expiration dates—the opening and closing of a call option position—or the purchase and sale of the same series of convertible debentures). Under these circumstances, the actual prices realized are likely to provide reasonable benchmarks for a section 16(b) short-swing profits calculation. Changes in valuation due to change in interest rates, the passage of time, or other factors are likely to be dominated by changes in valuation due to changes in the price or volatility of the underlying equity—factors that Congress intended to address through adoption of section 16(b). In circumstances where this benchmark is likely to misstate the short-swing profits attributable to changes in the price or volatility of the underlying equity, proposed Rule 16b-6(d)(2) would provide for the application of more precise measurement techniques. The Commission requests comment on the appropriateness of this

<sup>126</sup> In many cases, this type of stock swap will not result in a short-swing profit because the purchase and sale will take place at the same time. Further, if the swap was made pursuant to an employee benefit plan satisfying Rule 16b-3, the acquisition of the new security would be exempt.

<sup>127</sup> See *Kern County Land Co. v. Occidental Petroleum*, 411 U.S. 582, 601 (1973); *Bershad v. McDonough*, *supra*.

<sup>128</sup> See, e.g., R.A. Brealey & S.C. Meyers, *Principles of Corporate Finance* 484, Table 20-2 (1988, 3d ed.).

<sup>129</sup> See e.g., G. Castineau, *The Options Manual* 233 (1988, 3d ed.).

<sup>130</sup> See, e.g., Brealey & Meyers, *supra* n. 128; J. Cox & M. Rubinstein, *Options Markets* (1985); Castineau, *supra* n. 129.

<sup>131</sup> Brealey & Meyers at 488.

proposed benchmark and suggestions regarding other suitable approaches.

Proposed Rule 16b-6(d)(2) of Alternative A would address more complicated situations involving purchases and sales of derivative securities that do not have identical financial characteristics, as well as combined purchases and sales of derivative securities and underlying securities. For example, an insider may buy call options and then sell convertible debentures, or buy put options and then buy the underlying equity. Rule 16b-6(d)(2) sets the difference in price of the underlying security on the relevant trade dates as the maximum potential recovery. For example, if on January 1 an insider buys call options covering 1,000 shares when the underlying equity is trading at \$50 per share and on February 1 sells debentures convertible into 500 shares when the underlying equity is trading at \$60 per share, the maximum recovery in this situation would be \$5,000 (the \$10 per share change in valuation of the underlying equity between January 1 and February 1 multiplied by the 500 share equivalents purchased and then sold in the derivative securities transactions).

This measure of maximum recovery is most likely to approximate actual short swing profits in situations in which the purchases and sales involve derivative instruments that are deep in the money. This maximum recovery measure is likely to overstate short swing profits when at least one of the instruments purchased or sold was out of the money at the time of the transaction. This measure of maximum recovery does, however, provide a reasonable ceiling on profit recovery because, absent sharp changes in the volatility of the underlying security, the value of the option component of a derivative security will increase or decrease by no more than \$1 for every \$1 change in the value of the underlying equity.

Proposed Rule 16b-6(d)(2) also provides a rule of thumb for approximating short-swing profits in situations involving short-swing purchases or sales of dissimilar derivative securities. This rule of thumb would approximate short-swing profits by calculating the profits that would have been realized had the transaction involved only the security that was actually purchased or only the security that was actually sold. Thus, consider the previous example of a purchase of a call option covering 1,000 shares followed by the sale of debentures convertible into 500 shares. The short-swing profits realized in this transaction could be approximated either by (1)

calculating the price that would have been received on February 1 had the insider sold call options covering 500 shares at the same strike price as the options bought on January 1, and matching those proceeds against the January 1 purchase, or (2) calculating the price that would have been paid on January 1 had the insider purchased convertible debentures covering 500 shares and matching that acquisition cost against the February 1 sale. In effect, this rule of thumb translates the transaction that actually occurred into matched transactions in identical derivative securities. The rule of thumb then applies the valuation method proposed in Rule 16b-6(d)(1) to the reconstructed transaction.

The Commission requests comment on the appropriateness of the benchmarks and rules of thumb contained in proposed Rule 16b-6(d)(2) of Alternative A and specifically seeks discussion of situations in which these guidelines may be inappropriate or should be modified, as well as suggestions for further clarification that should be provided by the rule. The Commission also requests comment providing suggestions for other benchmarks or rules of thumb that can usefully be employed in situations involving purchases and sales of derivative instruments with dissimilar characteristics, or combined transactions involving both derivative securities and underlying securities.

The Commission recognizes, however, that benchmarks and rules of thumb are not appropriate in all situations. Accordingly, proposed Rule 16b-6(d)(3) of Alternative A would provide that, to the extent practical and necessary in order to provide an equitable measure of recovery, short-swing profits may be calculated through the application of more advanced valuation techniques, including the Black-Scholes model and its progeny, that specifically adjust the valuation of derivative securities for changes in a wide variety of factors. The Commission requests comment on the application of these valuation techniques in actions arising under section 16(b), whether more precise guidance regarding the application of these techniques can or should be provided, and any other matters relating to the method of calculating recoveries under section 16(b) for transactions involving derivative instruments.

As an alternative to the above measure of recovery, the Commission proposes a simple measure of recovery to cover all types of derivative securities, which is to be used in situations involving two different types of securities. Alternative B would define profits based upon the

price movement in the underlying security during the short-swing period in question.

The time of day of the transaction is important in determining profit because the price could fluctuate significantly during the day. Thus, if the convertible preferred was purchased in the morning, it is important to ascertain the value of the underlying stock at the same time.<sup>132</sup> If, for example, the underlying stock was always valued at the end of the day, the price could change enough to defeat the purpose of a standardized measure.<sup>133</sup>

While a more complex rule, such as Alternative A, might result in a more precise measure of profit, Alternative B would provide a simple measure of short-swing profit while leaving litigants free to propose and the courts free to adopt alternative measures of recovery.

Commenters should address which alternative rule is preferable. In addition, commenters are requested to address whether the calculation of profit is best left to the evolution of case law before the courts.

#### 4. Put Options

For purposes of section 16(b), a put option would be the mirror image of a call option. Acquisitions of put options would be considered sales of the underlying securities. Thus, a purchase of stock and a purchase of a put option, within six months, would be considered a short-swing transaction, subject to section 16(b). The exercise of a put option would be deemed an exempt disposition of the put option (if the option was in-the-money) and an exempt sale of the underlying securities. Thus, in-the-money put options would be eligible for the exercise exemption of proposed Rule 16b-6(b) and out-of-the-money puts would not. The rationale for the exemption would be the same as for call options, discussed above. Finally, the writing of a put option would be deemed a purchase of the underlying securities, as establishing a call equivalent position.

#### C. Short Sales

There has been uncertainty concerning the application of the short

<sup>132</sup> This could be done by contacting the exchange or quotation dissemination service. Most securities underlying derivative securities are publicly traded and subject to last sale reporting. See, e.g., 17 CFR 240.9b-1 (standardized options).

<sup>133</sup> For example, an insider could buy stock at \$10 per share in the morning, but by the end of the day bad news might send the price down to \$7. If the insider were to sell an option one month later when the stock was at \$9, a proposed measure based upon closing prices would yield a two dollar short-swing profit, when the insider actually lost one dollar.

sale prohibitions of section 16(c) to derivative securities.<sup>134</sup> In the absence of a rule, there has been only one judicial decision addressing the issue.<sup>135</sup> In that case the court found that the sale of a call option and a put option did not violate Section 16(c) for three reasons: (1) The writing of the option was not viewed as a rule of the underlying stock; (2) the writer of an option cannot control when an option is exercised, which enables the seller to qualify for the good faith "undue inconvenience" exemption of the provision; and (3) the Commission had failed to regulate trading in options. In the 26 years since the case was decided, much has changed. In particular, derivative securities have become more widespread and options are now traded on exchanges in accord with Commission regulations.

The proposed treatment of derivative securities is intended to subject derivative securities to the short sale prohibitions of section 16(c). The potential for abuse is not less when insiders establish put equivalent positions, rather than selling short underlying securities. Indeed, options were instrumental to insiders in the notorious "bear raids" of the early 1930's.<sup>136</sup> A reading of the legislative history indicates the Congress did not want insiders, with access to inside information, speculating in their company's stock by acquiring short positions. Further, Congress did not want insiders to take short positions in conflict with their fiduciary duties, because insiders could use short positions to manipulate a stock price or to profit by a fall in the price of their company's stock. Derivative securities can be used to establish a short position, even where the insider has large stock holdings. The proposed rule thus would ensure that an insider does not have an economic interest in the poor performance of the issuer's stock.

Under the proposal, insiders could establish put equivalent positions as a hedge<sup>137</sup> against underlying stock

positions. Proposed Rule 16c-4(a) would permit an insider to conduct these transactions, as long as the securities underlying those derivative securities do not exceed the underlying securities otherwise owned by the insider.<sup>138</sup>

This permits insiders flexibility in trading derivative securities. The exemption would be lost if the insider later sold enough underlying securities that the securities underlying the put equivalent positions exceeded the number of underlying securities otherwise owned.<sup>139</sup>

The proposed rule would permit trading derivative securities against a long underlying security position, but would not permit selling underlying securities short against derivative securities. The prior position is a legitimate conservative hedging strategy, whereas the latter position is more akin to true short selling.

The most abusive investment pools of the early 1930's (that involved short selling) involved short selling of the stock while holding options to protect against a price increase. In each pool mentioned in the legislative history, Congress was quite concerned that the pool insiders would not exercise the option but would instead repurchase the stock in the open market. This practice was viewed as unethical.<sup>140</sup> Based on this Congressional concern, no relief is proposed for short selling against derivative securities. Comment is requested, however, as to whether it is appropriate to differentiate between short selling against derivative securities and trading derivative securities against stock.

## V. Employee Benefit Plans

Section 16 can present an obstacle to corporate compensation plans that distribute or confer rights in employer securities. Distributions from such a plan or transactions within the plan are generally deemed to be purchases or sales within the meaning of section 16. However, the Commission, aware that some benefit or retirement plan transactions do not afford an opportunity for abuse of inside information, adopted current Rules 16a-8(b),<sup>141</sup> 16a-8(g)(3), and 16b-3<sup>142</sup> to exempt specified transactions. The first two rules provide an exemption from both reporting and short-swing profit

recovery for designated intratrust or intra-plan transactions. In contrast, Rule 16b-3 applies to distributions from a benefit plan and is an exemption from short-swing profit recovery only.

### A. Current Rules

Current Rule 16a-8(g)(3) provides an exemption for intra-trust transactions in indirect interests in portfolio securities held by "a pension or retirement plan holding securities of an issuer whose employees generally are the beneficiaries of the plan." The Commission has defined the term "pension or retirement plan" to mean a plan "in which participants generally are not entitled to receive a distribution until their death, retirement or other termination of employment."<sup>143</sup> The exemption is not available to plans with withdrawal provisions unless significant penalties are imposed upon withdrawal.<sup>144</sup> The exemption would be retained under proposed Rule 16a-5(d)(2)(iii).<sup>145</sup> Comment, however, is solicited on whether the exemption should be available only for transactions made without the prior approval or direction of the insider, paralleling proposed Rule 16a-8.

Current Rule 16b-3 provides an exemption for distributions of employer securities from plans that have been approved by shareholders and are administered by disinterested persons. It also permits participants to tender shares of stock to the employer to exercise an option and to cash-out SARs under specified circumstances.

### B. Proposed Rules

#### 1. General Scheme

The proposed amendments would effect three major changes to current Rule 16b-3: (1) Deletion of the shareholder approval requirement; (2) increased disinterested administration requirements; and (3) addition of a six-month holding requirement for derivative securities.

#### 2. Plan Awards and Distributions

a. *Shareholder approval.* Availability of current Rule 16b-3 is conditioned on the issuer's securing shareholder approval of the compensation plan and any material amendments to the plan.<sup>146</sup> Compensation plans must be described in the issuer's proxy statement,<sup>147</sup> and shareholder sanction

<sup>134</sup> Section 16(c) provides, in part, that it is unlawful for insiders to directly or indirectly sell any equity securities that they do not own or do not deliver within 20 days. There is a good faith exception. Short selling is discussed further in Section VI.D., *infra*.

<sup>135</sup> *Silverman v. Landa*, 306 F.2d 422 (2d Cir. 1962).

<sup>136</sup> The options were granted to the insiders so they would have protection when they sold short. If they were unsuccessful in manipulating the price down and were forced to cover their short sales, they could exercise the options and acquire the necessary stock. See *Stock Exchange Practices* at 51-52.

<sup>137</sup> The term "hedging" means lessening the risk of loss by offsetting the risk of a securities position with an opposite position in a related security.

<sup>138</sup> See 17 CFR 240.3b-3 (definition of short sale).

<sup>139</sup> Proposed Rule 16c-4(b).

<sup>140</sup> *Stock Exchange Practices* at 51-52.

<sup>141</sup> The Rule 16a-8(b) intra-trust transaction exemption applies to trusts generally, but is commonly used for benefit plans. For a discussion of that exemption, see Section III.A.5.e. *supra*.

<sup>142</sup> 17 CFR 240.16b-3.

<sup>143</sup> Release 34-18114 Q. 69 n.86.

<sup>144</sup> See Release 34-18114 Qs. 70, 71.

<sup>145</sup> See Section III.A.5.d., *supra*.

<sup>146</sup> 17 CFR 240.16b-3(a).

<sup>147</sup> 17 CFR 229.402.

of plan provisions has been viewed as a measure that deters insiders from implementing compensation plans that allow for abuse of inside information.

The shareholder approval requirement has been criticized as unclear, burdensome, and ineffective as a deterrent. The need to determine whether an amendment is material has resulted in a multitude of interpretive requests, many provoked by changes in plans in response to changes in the tax laws.<sup>148</sup>

The proposed rules would delete the requirement for shareholder approval and place greater reliance upon the disinterested administration requirement to assure that opportunities for abuse are minimized. Comment is requested, however, on whether the shareholder approval requirement should be retained or whether there are other mechanisms that provide better safeguards.

**b. Disinterested administration.** Under current Rule 16b-3, decisions regarding participation in and awards under an exempt plan must be made either (1) by a committee, the majority of whom are disinterested persons, or (2) by a pre-established formula.<sup>149</sup>

Under the proposed rule, the definition of "disinterested person" would be amended. Currently, a disinterested administrator is one who is not eligible for participation in any discretionary company plan and has not participated in any such plan for the past year. To be a disinterested administrator under the amended definition, a person could not participate in any discretionary plan of the issuer for the year before the transaction and could not be eligible to participate in any discretionary plan for the three years subsequent to the transaction. The exemption would be lost if an administrator failed to satisfy the conditions of the rule; loss of the exemption would not, however, be retroactive.

Given the multiplicity of plans an issuer frequently has, the Commission requests comment as to whether the rule should prohibit prior and/or future participation only in the plan as to

which the person is an administrator.<sup>150</sup> The Commission recognizes the administrative burdens the proposed rule will impose, and requests comment on alternative mechanisms that would serve adequately the purposes of section 16 and be more efficient from the issuer's perspective. The Commission also requests comment on whether the proposed prohibition on subsequent participation would be equally effective if it covered only a shorter period, such as one or two years.

The disinterested administration requirement in proposed Rule 16b-3(b)(1)(i) has been further revised to require an administrator to exercise sole discretion in administering the plan. This is similar to the current requirement in Rule 16b-3(e)(3)(ii) for SARs. Current Rule 16b-3(b) does not have a sole discretion requirement and, thus, the participant is permitted more investment control.

As an alternative, proposed Rule 16b-3(b)(1)(ii) provides that the disinterested administration requirement is satisfied if insiders exercise no control or discretion in awarding securities under any plan in which the administrator participated during the past year or participates in the following three years.<sup>151</sup> In these non-discretionary plans, securities awards are determined automatically by application of a formula. Given the proposed deletion of the shareholder approval requirement, the proposed rule would limit the number of amendments to the formula that could be made to one every six months. Comment is solicited as to whether amendments should be permitted more often if necessary to comport with tax law changes.

**c. Plan limitations.** Current Rule 16b-3(c),<sup>152</sup> which provides that plans must limit dollar and security awards to a fixed amount, would be deleted as unnecessary. The provision was intended to prevent adoption of open-ended plans that could avoid shareholder approval requirements. Since the Commission proposes elimination of the shareholder approval requirement, this safeguard would be unnecessary.

The proposal would add a new requirement that derivative securities be

held six months.<sup>153</sup> The change would be added to the definition of "plan" in proposed Rule 16b-3(c)(1)(ii), because this definition already imposes the requirement that securities awarded under a plan must be non-transferable. Because acquisitions of stock upon the exercise or conversion of a derivative security would be exempted under proposed Rule 16b-6(b), as discussed above, absent such a six-month holding requirement, short-term options, warrants, or rights could be used to undermine the purposes of section 16. For example, an acquisition of an option under the rule would be an exempt purchase and the immediate exercise of the option could be an exempt purchase of the underlying securities so that the immediate sale of the underlying stock would not result in a short-swing profit.

**d. Stock Appreciation Rights.** SARs appear in many different forms, but they generally have two common elements: The receipt of cash in tandem with or instead of stock, and a value governed by the market price of an underlying equity security. Current Rule 16b-3(e)<sup>154</sup> provides a safe harbor exemption from Section 16(b) liability for cash settlements of SARs. The safe harbor protects both the settlement for cash and the disposition of the SAR. A safe harbor was deemed necessary for the exercise of SARs to avoid the possibility that the exercise of an SAR would be determined to be a purchase of the underlying security, while the receipt of cash, instead of stock, would be deemed a concurrent sale of that security.<sup>155</sup> Thus, all profit resulting from the exercise of an SAR could be deemed to involve a short-swing profit subject to recovery under section 15(b). An SAR exercised for stock was simply viewed as a non-exempt purchase of securities.

The current safe harbor for cash-settled SARs was crafted with four conditions: (1) Information about the issuer must be current;<sup>156</sup> (2) the SAR must not be exercised in the first six months after grant;<sup>157</sup> (3) the disinterested plan administrators must have sole discretion over the form of payment or approval of the participant's election;<sup>158</sup> and (4) an election to

<sup>148</sup> See, e.g., *Centex Corp.* (Nov. 7, 1988) (withholding taxes); *Hibernia Corp.* (Nov. 23, 1987) (amendments to conform with recent changes in tax law).

<sup>149</sup> 17 CFR 240.16b-3(b). "Disinterested person" is defined in 16b-3(d)(3), which would be redesignated proposed Rule 16b-3(c)(3).

The disinterested administration requirement was adopted in 1949 [Exchange Act Release No. 4253 (May 6, 1949) [14 FR 2522]], deleted in 1956 [Exchange Act Release No. 5312 (May 21, 1956) [21 FR 3646]], and reinstated in 1960 [Exchange Act Release No. 6275 (May 26, 1960) [25 FR 4901]].

<sup>150</sup> The staff has interpreted the rules to permit participation in other plans of the issuer that are not subject to the discretion of any individual or committee (non-discretionary plans). See, e.g., *Hadco Corporation* (Oct. 19, 1987). This interpretation would be codified in proposed Rule 16b-3(c)(3).

<sup>151</sup> This is similar to current Rule 16b-3(b)(1)(iii).

<sup>152</sup> 17 CFR 240.16b-3(c).

<sup>153</sup> The general six month holding period requirement for options in current Rule 16b-6 would be rescinded.

<sup>154</sup> 17 CFR 240.16b-3(e).

<sup>155</sup> See Exchange Act Release No. 13097 (Dec. 22, 1976) [52 FR 754]; *Matas v. Seiss*, 467 F. Supp. 217 (S.D.N.Y. 1979) (an exercise of an SAR can be a simultaneous purchase and sale).

<sup>156</sup> 17 CFR 240.16b-3(e)(1).

<sup>157</sup> 17 CFR 240.16b-3(e)(2).

<sup>158</sup> 17 CFR 240.16b-3(e)(3)(i).

exercise the SAR must be made during the period beginning on the third business day and ending on the twelfth business day ("10 day window") following the release of the periodic financial information required under section 13 of the Exchange Act.<sup>159</sup>

Under the proposed rules, the acquisition by an insider who chose to receive stock in exercising an SAR that offered a cash-or-stock election would be exempt from short-swing profit liability.<sup>160</sup> If the insider chose to receive cash, an exemption from section 16(b) liability would continue to be provided under proposed Rule 16b-3(d), if the conditions imposed currently were satisfied. The exemption for the cash election protects against liability arising from an analysis that the elected cash settlement was a simultaneous purchase and sale of the equity securities. While proposed Rule 12b-6(b) would exempt the hypothetical acquisition, there would be no exemption for the hypothetical sale if not for that afforded by proposed Rule 16b-3(d).

Cash settled SARs issued under a section 16b-3 exempt plan that do not provide the holder with a stock election would be wholly exempt from section 16.<sup>161</sup>

*e. Effect of proposed changes on pre-existing plans.* The proposed changes to Rule 16b-3 could compel registrants to amend their benefit plans to comply with the proposed changes relating to disinterested administration and the six month holding period. Comment is solicited as to the need for a phase-in period or some other form of temporary relief should the proposed rules be adopted. Comment is further solicited as to whether the proposed changes should have only a prospective application, so that a plan need not be amended until there is a material change in the plan, which under the current rules requires shareholder approval. In such case, the issuer could avoid the necessity for shareholder approval (unless required by the terms of the plan) by amending the plan to comply with the new rules.

*f. Other changes.* Current Rule 16b-3(d)<sup>162</sup> defines several operative terms used in the Rule. The definitions would be retained without change in proposed Rule 16b-3(c), except that the definitions of "plan" and "disinterested person" would be amended to conform with the changes described above. It should be noted that the definition of "exercise of an option, warrant or right" in current

Rule 16b-3(d)(2) has been retained as proposed Rule 16b-3(c)(2). Although exercises generally would be exempt under proposed Rule 16b-6(b), this definition was retained because the transactions enumerated are deemed to be entirely outside the purview of section 16, both for reporting and liability purposes.

In addition, the introductory paragraph to Rule 16b-3 would be simplified and designated proposed Rule 16b-3(a). No substantive change is intended.

## VI. Synopsis of other changes

The other proposed changes are discussed in the order in which they would appear if the proposed amendments are adopted. A chart showing how the current rules would be restructured is included in Section IX below.

### A. Rules under Section 16(a)

#### 1. Definitions

*a. Equity security of such issuer.* Proposed Rule 16a-1(f) would define "equity security of such issuer" to include derivative securities overlying the issuer's equity securities, regardless of whether the derivative securities are issued by that registrant. Thus standardized and other third party options would be included in the definition, which codifies the Commission's interpretive position.<sup>163</sup> While standardized options had not been developed when section 16 was enacted, they are an equity security with great potential for abuse because they are short-term vehicles which offer the ability to leverage small investments into great profits. Consistent with the proposed treatment, Congress showed concern with all instruments known at the time of enactment (including issuer options) which provided an opportunity for abuse.<sup>164</sup>

*b. Owner of any security of the issuer.* Proposed Rule 16a-1(h) would define "owner of any security of the issuer" for purposes of section 16(b) short-swing profit recovery actions. The statute provides that, if the issuer fails to bring suit within 60 days of demand, such an owner may institute suit in the name and on behalf of the issuer to capture short-swing profits.

The section 16(b) action is similar to a derivative action under the Federal Rules of Civil Procedure.<sup>165</sup> However,

there are differences, primarily with respect to standing. Unlike standard derivative actions, there is no requirement that a plaintiff have held the shares at the time of the alleged short-swing trading.<sup>166</sup> In fact, a plaintiff may achieve standing by purchasing a nominal number of shares of the issuer's stock subsequent to the discovery of a short-swing transaction.<sup>167</sup> Currently, the plaintiff is required to hold these shares throughout the legal process.<sup>168</sup> As set forth below, this result would be changed if the plaintiff ceased to be an owner because of a statutory merger or consolidation or other transaction over which the individual shareholder had no control.

When an issuer merges with and becomes a wholly-owned subsidiary of another company, shareholders of the issuer are compelled to dispose of their securities, receiving either cash or securities of the acquiring company. One court permitted a former shareholder of the issuer and current shareholder of the parent to bring a section 16(b) action when the issuer ceased to exist as a separate entity.<sup>169</sup> Where the issuer continues to exist as a wholly-owned subsidiary, however, the courts have uniformly denied standing to former shareholders and shareholders of the parent.<sup>170</sup> Thus, potential section 16(b) defendants in the acquired companies are shielded from liability, unless the parent decides to sue the former insiders of its subsidiary.

This result undercuts the policing function played by shareholders in section 16(b) actions. To preserve Congress' intent, the proposed rules would provide standing to the former public shareholders whose equity securities have been acquired in a business combination or similar corporate transaction over which the individual shareholder had no control.

The proposed rule would define "owner of any security of the issuer" as either a current beneficial owner of securities of the issuer (at the time of filing the suit) or a former beneficial owner who was compelled to dispose of

<sup>159</sup> See, e.g., *Blau v. Mission Corp.*, 212 F.2d 77 (2d Cir.), cert. denied, 347 U.S. 1016 (1954) (distinguishing Rule 23.1); see also *Portnoy v. Kawecki Beryco Industries, Inc.*, 607 F.2d 765, 767 n.3 (7th Cir. 1979).

<sup>160</sup> *Morales v. Great American Corp.*, 445 F. Supp. 869 (M.D. La. 1978).

<sup>161</sup> *Portnoy v. Kawecki Beryco Industries, Inc.*, supra.

<sup>162</sup> See *Blau v. Oppenheim*, 250 F. Supp. 881 (S.D.N.Y. 1966).

<sup>163</sup> *Untermeyer v. Valhi, Inc.*, 841 F.2d 26 (2d Cir.), cert. denied, 109 S. Ct. 175 (1988); *Lewis v. McAdam*, 762 F.2d 800 (9th Cir. 1985) (per curiam); *Portnoy v. Kawecki Beryco Industries, Inc.*, supra.

<sup>159</sup> 15 U.S.C. 78m (1982).

<sup>160</sup> See proposed Rule 16b-6(b).

<sup>161</sup> See proposed Rule 16a-1(c), discussed at Section IV.A.1., supra.

<sup>162</sup> 17 CFR 240.16b-3(d).

<sup>163</sup> See Release 34-18114 Qs.21, 54.

<sup>164</sup> See generally Stock Exchange Practices at 51-52 (short selling against options); *id.* at 7541-7543 (perferred stock).

<sup>165</sup> Fed. R. Civ. P. Rule 23.1.

the securities because of a business combination resulting in the issuer's becoming a non-reporting company.<sup>171</sup> This would address situations where the issuer becomes a subsidiary of another company as well as situations involving leveraged buy-outs and other forms of securities ownership redistribution. The standing would be determined at the time of suit and would not be affected if the issuer returned to reporting status during pendency of the action.

Comment is requested whether the definition should include only those former shareholders who are current shareholders of the parent company that controls the former company. The former shareholder who is a shareholder of the parent company that would receive the short-swing profit could be expected to have an economic interest in pursuing the case. Comment is also requested on alternative definitions of publicly owned company other than one referring to reporting status. The purpose of the definition is to assure that a section 16(b) action could be brought by security holders unaffiliated or unassociated with the controlling person.

## 2. Distributions

Current Rule 16b-2<sup>172</sup> would be moved from the section 16(b) rules to the Section 16(a) rules because there is little need for reports that disclose trades carried out as part of a distribution. The Commission promulgated Rule 16b-2 to exempt from section 16(b) transactions by persons involved in a distribution if three conditions are met: (1) The person must be in the business of distributing substantial blocks of stock and participating in the underwriting in good faith and in the ordinary course of business; (2) the security involved must be part of a substantial block of stock acquired with a view to distribution or the security must have been purchased to cover an over-allotment or to stabilize the market price; and (3) non-insider underwriters must participate in the distribution on terms as favorable, and to an equal extent, as the underwriters that are deemed to be insiders of the issuer ("equal participating requirement").<sup>173</sup>

The Commission proposes to eliminate the equal participation requirement. Transactions can be structured to avoid this requirement,<sup>174</sup>

and it appears to address competitive concerns rather than the potential for abuse of inside information.

As with the current rule, proposed Rule 16a-17 would apply only to distributions and not to sales from an investment account of the seller.<sup>175</sup>

## 3. Exemptions for Both 16(a) and 16(b)

Current Rule 16a-10<sup>176</sup> would be retained with one minor change, the inclusion of the clause "except as provided in § 240.16a-6." The Rule would provide generally that any transaction exempted by a rule pursuant to section 16(a) likewise will be exempted from section 16(b), with the exception of proposed Rule 16a-6, which would provide a reporting deferral for small acquisitions, rather than an exemption.

## B. Exemptive Rules under Section 16(b)

### 1. Transactions Approved by Regulatory Authority

Proposed Rule 16b-1 would exempt from the operation of section 16(b) specified transactions effected by issuers registered under the Investment Company Act and the Public Utility Holding Company Act, as well as exchanges of securities by persons subject to the Interstate Commerce Act ("Commerce Act").<sup>177</sup> The proposed rule would combine the current provisions of Rules 16b-1,<sup>178</sup> 16b-4,<sup>179</sup> and 16b-10<sup>180</sup> into a single rule without substantive change.

Current Rule 16b-1 exempts trades by registered investment companies where both the purchase and sale are exempt from the provisions of section 17(a) of the Investment Company Act, by order of the Commission pursuant to section 17(b).<sup>181</sup> Rule 16b-4 now exempts trades by public utility holding companies, or their subsidiaries, where both the purchase and sale have been approved or permitted by rules pursuant to the Public Utility Holding Company Act. Existing rule 16b-10 exempts exchanges by railroads that are approved by the Interstate Commerce Commission ("ICC") if the securities are acquired by persons subject to Part One of the Commerce Act, the acquirer is ordered to dispose of all securities exchanged for acquired securities, issuance of the securities was approved

by the ICC pursuant to section 20(a)<sup>182</sup> of the Commerce Act, and the acquirer has transferred voting rights of the issuer's stock to a bank or trust until final disposition.

Proposed paragraph (a) of Rule 16b-1 would contain one clarifying change, to reflect the current staff interpretation that the exemption from section 16(b) embodied in current Rule 16b-1 is available where an issuer has not obtained a formal order from the Commission pursuant to the Rule's requirements, but instead meets the conditions of an exemptive rule under section 17(a) of the Investment Company Act.<sup>183</sup>

## 2. Bona Fide Gifts and Inheritance

Proposed Rule 16b-5 would exempt all acquisitions and dispositions via bona fide gifts or the laws of descent. Current Rule 16a-9 provides an exemption from section 16(b) for gifts under \$10,000 and a reporting deferral (until the next required Form 4) for purposes of section 16(a).<sup>184</sup>

a. *Gifts.* There has been some uncertainty as to whether a gift is a sale for purposes of section 16. The issue has been addressed in three cases, all of which found that a bona fide gift was not a sale within the meaning of section 16.<sup>185</sup> Yet, the presence of a partial exemption for small gifts in Rule 16a-9 may undercut the holdings of those cases. The proposed rule would expand the exemption explicitly to cover all bona fide gifts. Bona fide gifts are those that are not required or inspired by any legal duty or that are in any sense a payment to settle a debt or other obligation,<sup>186</sup> and not made with thought of reward for past services or hope for future consideration. Employee benefit plan awards would not be considered gifts.

The Commission proposes to eliminate the reference to gifts in Rule 16a-9 and create a short-swing profit exemption in proposed Rule 16b-5(a), with deferred reporting required under proposed Rule 16a-3(f). Bona fide gifts present less likelihood for opportunities for abuse. Comment is solicited on the appropriateness of this exemption.

<sup>171</sup> 49 U.S.C. 11301 (1982).

<sup>172</sup> Release 34-18114 Q.81.

<sup>173</sup> As noted above in Section III.B.3., the reporting deferral for small acquisitions not involving gifts is retained as proposed Rule 16a-6.

<sup>174</sup> *Shaw v. Dreyfuss*, 172 F.2d 140 (2d Cir. 1949), cert. denied, 337 U.S. 907 (1949); *Lewis v. Adler*, 331 F. Supp. 1258, 1268 (S.D.N.Y. 1971); *Truncala v. Blumberg*, 80 F. Supp. 387 (S.D.N.Y. 1948).

<sup>175</sup> See Staff Accounting Bulletin 65 n.6 (Nov. 5, 1986).

or they can delay registration under section 12 until after the initial distribution.

<sup>176</sup> See generally Release 34-18114 § IV.B.

<sup>177</sup> 17 CFR 240.16a-10.

<sup>178</sup> 49 U.S.C. 10101-11917 (1982).

<sup>179</sup> 17 CFR 240.16b-1.

<sup>180</sup> 17 CFR 240.16b-4.

<sup>181</sup> 17 CFR 240.16b-10.

<sup>182</sup> 15 U.S.C. 80a-17(a), 80a-17(b) (1982).

<sup>171</sup> The two year statute of limitations would not be affected.

<sup>172</sup> 17 CFR 240.16b-2.

<sup>173</sup> See generally Rules 16b-2 and 16c-2 (Oct. 6, 1987).

<sup>174</sup> Underwriters or dealers can sell the securities on an agency, rather than a firm commitment, basis,

b. *Inheritance.* There is no current rule to exempt transactions which occur as a result of the laws of descent. Under proposed Rule 16b-5(b), the Commission would exempt from section 16(b) both acquisitions and dispositions of equity securities through will or testament.<sup>187</sup> These transactions, however, would be disclosed on Form 5.

### 3. Dividend or Interest Reinvestment Plans (DRIPs)

Current Rule 16a-11<sup>188</sup> provides an exemption from both section 16(a) reporting and section 16(b) profit recovery for dividend or interest reinvestment made pursuant to a plan available on the same terms to all holders.<sup>189</sup> While there are those who advocate extending the rule to exempt additional cash contributions to these plans, the proposed rules would not do so. Additional capital contributions call for an investment decision that could benefit from access to non-public information. Comment is requested, however, on whether a reporting deferral until the annual Form 5 would be appropriate for these additional capital contributions, even though they are not exempt from section 16(b). In addition, proposed Rule 16b-9 would limit the exemption to one from short-swing profit recovery.<sup>190</sup> No other substantive changes are proposed.

### C. Other Rules Affected

#### 1. Rule 12h-2

The proposal would rescind Rule 12h-2<sup>191</sup> as being no longer necessary. The rule provides an exemption from section 16 for specified pre-registration transactions, but the exemption is limited to transactions in the securities of issuers registering pursuant to Section 12 prior to November 1, 1967.

#### 2. Rule 30f-1

Rule 30f-1<sup>192</sup> of the Investment Company Act would be amended to clarify that satisfying the reporting provisions under section 16(a) would satisfy section 30(f) of the Investment Company Act as well. Additionally, the amended rule would clarify that the rules under Section 16 of the Exchange Act apply to registered closed-end investment companies within the ambit of section 30(f). The proposed change would broaden Rule 30f-1 to require proposed Form 5.

### D. Short Sale Prohibition<sup>193</sup>

Section 16(c) prohibits the sale of any equity security of the issuer if the selling insider either (1) does not own the security or (2) even if owning it, does not deliver it within 20 days after sale or mail it within 5 days.<sup>194</sup> An exemption is provided for persons acting in good faith who cannot deliver the securities in time, without undue inconvenience or expense.

Although the legislative history concerning section 16(c) is sparse, it indicates that Congress was concerned about and intended to eliminate abuses attendant on short selling. The legislative history focuses on investment pool operations conducted by certain insiders in conjunction with exchange members, which involved short selling that permitted them to repurchase shares at a much lower price.<sup>195</sup> These practices became known as "bear raids." In essence Congress was concerned about the manipulative effect of short selling and appeared to be troubled that insiders were taking positions that would benefit by an adverse movement in the price of the company's stock.

Total elimination of short selling was considered, but proponents argued that short sales were necessary to the market.<sup>196</sup> Congress decided to give the Commission general authority to regulate short selling in section 10(a)<sup>197</sup> of the Act, but specifically prohibited insiders from engaging in short sales.

Under the proposed rules, as described below, the three current rules under section 16(c) would not be changed substantially. Current Rule 16c-1<sup>198</sup> provides an exemption for brokers who execute short sales for others, and Rule 16c-3<sup>199</sup> provides an exemption for securities sold with the designation "when issued." No changes are proposed. Rule 16c-4 would be added to help eliminate the uncertainty surrounding short sales and derivative securities.<sup>200</sup> The rule would provide an

exemption for hedging transactions with derivative securities.

Current Rule 16c-2<sup>201</sup> provides an exemption for an underwriter where the sale is an over-allotment of an underwriting group and there is a good faith intention to offset the short position with a later purchase. Rule 16c-2(b) requires, similarly to current Rule 16b-2, that the insider underwriter must permit other members of the distributing group to participate equally. As with proposed Rule 16a-7, the Commission proposes deletion of the equal participation requirement of Rule 16c-2(b) as being unnecessary.

### E. Market Making Exemption

Section 16(d) was added in 1964 in order to provide an exemption for over-the-counter ("OTC") market makers from sections 16(b) and (c). The exemption covers only market making transactions and excludes transactions for the market maker's investment account. There are no rules promulgated under section 16(d), although the section provides specific rulemaking authority to define "investment account." The proposed rules would not define the term, since no problems have been noted; however, the Commission solicits comment on the need for guidance in this area.

There is one aspect of section 16(d) that has been the subject of repeated interpretive requests—whether market makers are required to report transactions under section 16(a). The statute does not provide an express exemption from section 16(a) for market makers.<sup>202</sup> Given the changes in OTC trading and surveillance, however, the staff has issued interpretive letters exempting market makers from reporting.<sup>203</sup> Proposed Rule 16d-1 would codify the interpretive position. There appears to be little utility in requiring market maker reports where positions change constantly and the burden would be overwhelming.

### F. Arbitrage

Section 16(e) provides an exemption from all of section 16 for bona fide arbitrage transactions. The Section gives the Commission rulemaking authority to define "bona fide arbitrage," but the Commission has not exercised this

<sup>193</sup> See discussion about short selling and derivative securities in Section IV.C., *supra*.

<sup>194</sup> The alternative delivery provision appears to have been a response to comments from the San Francisco Stock Exchange that, when doing business with investors in the Philippines, Hawaii, and other islands, it was difficult to ensure that securities could be delivered in time. Stock Exchange Practices at 6836.

<sup>195</sup> See Stock Exchange Practices at 50-68.

<sup>196</sup> See generally Stock Exchange Practices at 53-55.

<sup>197</sup> 15 U.S.C. 78j(a) (1982).

<sup>198</sup> 17 CFR 240.16c-1.

<sup>199</sup> 17 CFR 240.16c-3.

<sup>200</sup> See proposed Rule 16c-4, discussed in Section IV.C., *supra*.

<sup>201</sup> 17 CFR 240.16c-2.

<sup>202</sup> See S. Rep. No. 379, 88th Cong., 1st Sess. 23 (1963).

<sup>203</sup> See *Prudential-Bache Securities Inc.* (December 2, 1985); *L.F. Rothschild, Unterberg, Towbin* (October 28, 1983); see also *Simon v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 482 F.2d 880, 886 (5th Cir. 1973) (court implied that a market maker need not report trades).

<sup>187</sup> See Stock Exchange Practices at 6558 (discussing securities passing to an estate).

<sup>188</sup> 17 CFR 240.16a-11.

<sup>189</sup> Exchange Act Release 34-18114 Q.78.

<sup>190</sup> See Section III.B.2., *supra*.

<sup>191</sup> 17 CFR 240.12-h-2.

<sup>192</sup> 17 CFR 240.30f-1.

authority, opting instead to leave such interpretation to the courts.<sup>204</sup> Only one rule has been promulgated under section 16(e)<sup>205</sup> and it prohibits officers and directors from using the exemption because they should not be engaged in performing arbitrage functions in their company's stock.

No changes and no additional rules are proposed, but comment is solicited as to whether further guidance in this area is needed.

#### VII. Revisions to Forms 3 and 4

The Commission proposes several minor revisions to Forms 3 and 4 and their instructions in order to enhance their usefulness, eliminate unnecessary provisions, and conform them to the proposed changes to section 16 described in the other sections of this release.

##### A. Revisions Common to Forms 3 and 4

1. The instructions to the forms captioned "When Statements are to Be Filed" and "Where Statements are to Be Filed" would be combined. A sentence would be added to the combined instruction stating that reporting persons shall file a duplicate original of the form with the issuer pursuant to proposed Rule 16a-3(e).

2. References appearing throughout the forms and instructions thereto to "puts," "calls," "options," "warrants," "convertible debentures," would be deleted and replaced with a general reference to "derivative securities."

3. The sequence of items in Tables I and II of the forms would be rearranged.

4. The instruction to the forms captioned "Statement of Amounts of Securities" would be revised to clarify that only those reporting pursuant to section 17(a) of the Public Utility Holding Company Act or section 30(f) of the Investment Company Act need to report debt securities.

The instruction also would be revised to state that a person owning securities beneficially through a trust, partnership, corporation or other entity shall indicate only the amount of securities representing the person's proportionate interest in the transaction or holdings of that entity. At the filer's option, the entire amount of the entity's holdings may be indicated instead of the proportionate interest. Other information concerning indirect ownership of securities in this paragraph would be deleted and addressed under the instruction captioned "Type of Ownership of Securities."

5. Two categories relating to the type and nature of reporting persons' beneficial ownership of securities, rather than just one, would appear in Tables I and II of the forms. In one category, reporting persons would indicate whether their ownership is direct or indirect; in the other category, reporting persons would describe the nature of any indirect ownership of securities.

6. The instruction to both forms captioned "Nature of Ownership of Securities" would be re-captioned "Type of Ownership of Securities" and revised to include all information regarding direct ownership in the first paragraph, and all information regarding indirect ownership in the second paragraph. The statements currently appearing in the second paragraph that discuss when a reporting person may be regarded as the indirect beneficial owner of securities would be deleted and replaced with a reference to proposed Rule 16a-1(a), which defines the term "beneficial owner." A statement would be added to clarify that securities holdings attributed to a reporting person due to the person's interest in a trust, partnership, corporation, or other entity are considered to be owned indirectly. A third paragraph would be added to provide information regarding disclaimers of beneficial ownership.

7. The instruction to the forms captioned "Puts, Calls, Options and Other Rights—Table II" would be recaptioned "Type of Derivative Security" and revised to state that reporting persons shall state whether a derivative security reported represents a right to buy, a right to sell, an obligation to buy, or an obligation to sell, the underlying security.

8. New columns would be added to Table II of the forms for information concerning the type and nature of ownership of derivative securities.

##### B. Revisions Related Only to Form 3

1. The instruction captioned "Price at Which Options may be Exercised" would be deleted.

2. Paragraph (b) of the instruction captioned "Reporting of Ownership in Certain Cases" would be revised to delete the reference to transferable warrants. The instruction currently states that transferable warrants issued by the issuer of the security subject to the warrants shall be reported in Table I; since transferable warrants are derivative securities, they would be reported in Table II of the Form 3, as revised, and no special instruction would be necessary.

The portion of the paragraph relating to convertible securities also would be

revised. At present, it indicates that in reporting the ownership of a convertible security, the number of shares or units subject to the conversion privilege should be set forth in the explanation space on page 2 of the form. The revised instruction would state that only common stock convertible into another type of common stock shall be reported in this manner (i.e., the common stock should be reported in Table I with an explanation on page 2 of the form that it is convertible into another type of common stock) and that all other convertible securities shall be reported as derivative securities in Table II of Form 3.

##### C. Revisions Related Only to Form 4

1. The instruction captioned "All Transactions to be Reported" would be re-captioned "Transactions to Be Reported" and revised to indicate that only transactions required to be reported on the Form 4, and not necessarily every transaction consummated by the reporting person, shall be so reported.

2. The instruction captioned "Character of Transaction" would be deleted. Instead, a new category captioned "Code for Character of Transaction" would be added to Tables I and II on Form 4. Reporting persons would choose a code from a list appearing on Form 4 that best identifies the character of the transaction being reported. Many types of transactions currently listed under the "Character of Transaction" caption would not have to be reported on the Form 4 under the proposed rules.

3. Paragraph (b) to the instruction captioned "Reporting of Transactions" would be revised to delete the reference to transferable warrants since, as stated in Section V.B.2 above, there is no reason to distinguish them from other types of derivative securities. The portion of the paragraph relating to the acquisition or disposition of convertible securities also would be revised in the manner set forth in Section VII.B.2. Finally, the last sentence in paragraph (b) would be deleted since conversions and exercises of derivative securities would, in most instances, be reported on Form 5 under the proposed rules.

4. Paragraph (d) of the instruction captioned "Reporting of Transactions" would be deleted. The first and second sentences in this paragraph state that certain types of derivative securities shall be reported in Table II. Since many of these transactions would be reported on Form 5, rather than on Form 4, under the proposed rules, and the revised Form 4 would indicate clearly that all

<sup>204</sup> See *Falco v. Donner Foundation*, 208 F.2d 600 (2d Cir. 1953) (court defines bona fide arbitrage).

<sup>205</sup> 17 CFR 240.16e-1.

transactions in derivative securities shall be reported in Table II, these directions would not be necessary. The last sentence of the paragraph states that transferable warrants shall be reported in Table I; this sentence would be deleted for the same reasons set forth in Section VII.C.3 above.

5. The instruction captioned "Statement of Dates" would be deleted. Instead, the information contained in the instruction would be incorporated in the "Date of Transaction" category on the form itself.

6. The instruction currently captioned "Statement of Dates" contains a reference to stock splits. That reference would be deleted from the instructions to the revised form because stock splits would be reported on Form 5 under the proposed rules.

7. A new category captioned "Purchase or Sale Price of Derivative Security" would be added to Table II of Form 4.

8. The instruction captioned "Purchase or Sale Price of Securities" would be revised to state that if a transaction did not involve cash, the nature of the consideration given or received shall be disclosed. The current instruction states that no information regarding the purchase or sale price of securities need be given for transactions not involving cash.

The instruction to Form 4 captioned "Beneficial Ownership at End of Month" would not be revised; however, comment is solicited as to whether the commission should continue to require reporting persons to report their month-end beneficial ownership of securities in which no transactions have been conducted. In light of the fact that the proposed Form 5 would require an annual reconciliation of beneficial holdings, this month-end information may not prove as useful or necessary as in the past.

#### D. Special Instructions—Privacy Act of 1974

A set of instructions would be added to the instructions to both forms regarding reporting persons' disclosure of their social security account numbers. The Commission issued a release in 1975<sup>206</sup> stating that, in light of section 7 of the Privacy Act of 1974,<sup>207</sup> it would no longer require that social security account numbers be disclosed on certain forms, including Forms 3 and 4, that collect information from or about individuals. In order to avoid the costs that would have been involved in

revising the forms to include the new instructions, a special notice was prepared indicating that disclosure of social security numbers is voluntary. This notice has been furnished to all persons requesting copies of Forms 3 and 4 from the Commission. Since additional revisions to the forms are being proposed, the Commission proposes to incorporate these special instructions into the forms.

#### VIII. Compliance with Section 16(a)

##### A. Lack of Compliance with Section 16(a)

The Commission is very concerned over the widespread lack of compliance with the reporting requirements under section 16(a). A review by the Commission of filings in calendar year 1987 indicated that more than 50 percent of filings made were more than three days late.<sup>208</sup> The high delinquency rate led to an increased focus on Forms 3 and 4 by the Commission's delinquent filing program, which identifies and prosecutes non-compliance with the filing requirements of the federal securities laws.<sup>209</sup> The Commission's staff has sent individual notices to persons and entities that repeatedly are late in filing their Form 4 reports and provided interpretive guidance in an effort to improve compliance with section 16(a).<sup>210</sup> In addition, the

<sup>208</sup> The review showed a 48 percent rate in 1986, and a 43 percent rate in 1988. A recent private study of more than 100,000 trades by reporting persons consummated between August, 1986 and July, 1987, came to similar results. See generally Novack, *State Dope*, FORBES, Nov. 2, 1987, at 180 (discussing a study by Jonathan Bentley); see also "The Bentley Report, Statutory Insider Trading 1983 to 1987" (1988) (this more recent study by Jonathan Bentley covering only the 1,000 largest issuers registered under section 12 and, among the other registered issuers, the 1,000 with the most active trading by insiders revealed a delinquency rate of about 33 percent). The earlier Bentley study, discussed by Novack, indicates that 40% of required sell reports and 39% of required buy reports on Form 4 were filed with the Commission at least three days late. The three day standard was used to allow for delays in the mail. Approximately 36% of the late buy reports and 26% of the late sell reports were overdue by one month or more. Moreover, \$8 billion of the \$26 billion worth of stock trades analyzed allegedly were not reported until beyond the filing deadline. Of the \$8 billion, more than \$5 billion, or about 60% in market value of the trades, were filed two months or more after the trades occurred. These problems in compliance were found to exist in three out of every four companies involved in the study. These statistics do not reveal fully the extent of the compliance problem since the delinquency figures do not reflect purchases or sales for which no reports were filed.

<sup>209</sup> See, e.g., *SEC v. Beall*, *SEC v. Geiringer*, *SEC v. Shanley*, Litigation Release No. 11326 (Jan. 6, 1987); *SEC v. Lee*, *SEC v. Michael Industries, Inc.*, *SEC v. Ziegler*, Litigation Release No. 11191 (Aug. 11, 1986).

<sup>210</sup> See Release 34-18114 and numerous interpretive letters addressing the section 16(a) reporting requirements.

commission has recommended federal legislation that would provide it with fining authority for violations of section 16(a).<sup>211</sup>

##### B. Discussion of Proposals

While the proposed revisions to the rules under section 16, particularly the deferral of a number of transactions to an annual report and the requirement of an annual reconciliation, should reduce the amount of delinquencies due to insiders' oversight, the Commission believes further steps are necessary to address the problem. It is therefore proposing to amend the proxy rules, Form 10-K, and Form N-SAR to add a new Item 405 to Regulation S-K. The Item would require disclosure of delinquent filers and a brief discussion of the procedures designed by the registrant to assist insiders in meeting their filing obligations under sections 16(a) and 16(b).

The information about delinquent filers would consist of the names of all directors, officers, and ten percent holders that fail to comply with the filing requirements of section 16(a) during the registrant's fiscal year by failing to file or filing late any required Form 3, 4 or 5 and how many times each such person failed to file or failed to file in a timely manner. Comment is solicited as to whether registrants should also be required to disclose the dollar amount involved and the nature of the transactions not reported. It should be emphasized that proposed Item 405 specifies that the registrant is required to report only those delinquencies disclosed on the Forms 3, 4 and 5. There would be no further duty of inquiry.

As noted above, all reporting persons would be required to send copies of all of their Form 3, 4 and 5 reports to the registrant pursuant to proposed Rule 16a-3(e).<sup>212</sup> In addition, many registrants already assist their reporting persons in fulfilling the requirements of Section 16(a) and the Commission, by this action, anticipates that it will provide incentives to registrants to implement procedures to assist their insiders to the extent they do not already do so.<sup>213</sup>

<sup>211</sup> Letter to the Hon. George Bush, President United States Senate, from David S. Ruder, Chairman (Sept. 28, 1988). The proposed bill would be entitled the "Securities Law Enforcement Remedies Act of 1988." Should the Commission proposed bill be enacted, the Commission will consider permitting a six month grace period before seeking fines from insiders failing to comply.

<sup>212</sup> See *supra* Section III.B.3.

<sup>213</sup> See American Society of Corporation Secretaries, Inc., "Section 16 Survey Report" (Nov. 1988) (reporting that the majority of responding members of the organization assist their insiders).

<sup>206</sup> Exchange Release No. 11831 (Nov. 14, 1975) [40 FR 55318].

<sup>207</sup> 5 U.S.C. 552(a) (1982 and Supp. 1986).

The Item 405 disclosure would be required to be disclosed in the proxy statement by new Item 7 of Schedule 14A and in the Form 10-K by new Item 10 and in Form N-SAR by new Item 88.E. Pursuant to Item 7 of Schedule 14A, the disclosure would appear in all proxy and information statements relating to the election of directors. The requirement would supplement the information concerning directors, executive officers, and certain beneficial holders already provided under Item 10 of Part III of Form 10-K.<sup>214</sup>

Registrants would have a duty only to disclose information derived from reviewing Form 3, 4, and 5 filings by directors, officers, and ten percent holders for timeliness and disclosures revealing transactions in violation of section 16(a) that occurred during the year. Registrants may rely on Schedule 13D and 13G filings for the identities of

their ten percent holders. All filings received by the registrant with a postmark after the due date should be presumed late, unless the reporting person demonstrates to the registrant that the form was filed timely with the Commission. (As provided by proposed Rule 16a-3(g), discussed above, the filer may be able to rely on the mailing date.) No additional inquiry by the registrant is necessary.

#### C. Request for Comment

The Commission solicits comment as to whether a distinction should be made between ten percent holders and directors and officers for purposes of the delinquent filers and compliance assistance procedures disclosure proposal. Specifically, comment is solicited as to whether ten percent holders should be excluded from the proposed disclosure requirement on

grounds that the relationship between registrants and ten percent holders is substantially different and less direct than the relationship between registrants and their directors and officers.

Commenters are asked to comment on the effect of the proposed rule changes on compliance with the section 16(a) reporting requirements. The Commission also solicits comment on additional or alternative means to improve the prompt disclosure to investors of the information required by Forms 3 and 4.

#### IX. Proposed Treatment of Current Rules

A. The following chart lists the current rules and the corresponding proposed rules and indicates which rules would be changed substantively or reorganized.

<sup>214</sup> General Instruction G(3) to Form 10-K states that the information required by Part III shall be incorporated by reference from the registrant's definitive proxy or information statement which

involves the election of directors, if such statement is filed with the Commission not later than 120 days after the end of the fiscal year covered by the Form 10-K. The instruction further states that if such

proxy or information statement is not filed with the Commission in the 120-day period, the items comprising the Part III information must be filed as part of the Form 10-K, or as an amendment to the Form 10-K filed under cover of Form 8 not later than the end of the 120-day period.

Current rule	Content	Proposed rule	Substantive changes
12h-2	Offerings before 1967	Deleted	Yes.
16a-1(a)	Forms 3 and 4	16a-3(a)	No.
(b)	Filing another Form 3	16a-3(b)	No.
(c)	Copies to exchange	16a-3(c)	No.
(d)	Pre-insider reporting	16a-2(a)	No.
(e)	Post-insider reporting	16a-2(b)	No.
16a-2(a)	10 percent holders	16a-1(a)	Yes.
(b)	Derivative securities	deleted	Yes.
16a-3	Disclaimer	16a-1(a)(4)	No.
16a-4	Fiduciaries	16a-5(b)	No.
16a-5	Odd-lot dealers	16a-9	No.
16a-6	Derivative securities	16a-4	Yes.
16a-7	Multiple filings	16a-3(d)	No.
16a-8	Trusts	16a-5 and 16a-8	Yes.
16a-9	Small trades and gifts	16a-6 and 16b-5	Yes.
16a-10	Exemption from Section 16(b)	16a-10	No.
16a-11	DRIPs	16b-9	No.
16b-1	Investment companies	16b-1	No.
16b-2	Underwriters	16a-7	Yes.
16b-3	Benefit plans	16b-3	Yes.
(a)	Shareholder approval	Deleted	Yes.
(b)	Disinterested administration	16b-3(b)	Yes.
(c)	Plan limits	Deleted	Yes.
(d)	Definitions	16b-3(c)	Yes.
(e)	SARs	16b-3(d)	No.
16b-4	Utility holding companies	16b-1(b)	No.
16b-5	Redemptions	16b-4	No.
16b-6	Options	16b-6	Yes.
(a)	Holding period	Deleted	Yes.
(b)	Formula	16b-6(d)	Yes.
(c)	Mergers	16b-6(c)	Yes.
(d)	Short sales	Deleted	Yes.
(e)	Burden of Proof	Deleted	Yes.
(f)	Prior judgments	Deleted	Yes.
16b-7	Mergers	16b-7	No.
16b-8	Voting trusts	16b-8	No.
16b-9	Conversions	16b-6(b)	Yes.
16b-10	Railroads	16b-1(c)	No.
16b-11	Subscription rights	16b-2	No.
16c-1	Brokers	16c-1	No.
16c-2	Underwriters	16c-2	Yes.
16c-3	When-issued securities	16c-3	No.
16e-1	Arbitrage	16e-1	No.
30f-1	Investment Companies	30f-1	No.

\* \* \* \* \*

B. The following chart lists the proposed rules and the corresponding

current rules, and indicates which current rules would be changed

substantively or reorganized.

Proposed rule	Content	Current rule	Substantive changes
16a-1(a)(1-3).....	Beneficial Owner .....	None.....	N/A
(a)(4).....	Disclaimer.....	16a-3.....	No.
(b).....	Immediate Family.....	None.....	N/A
(c).....	Derivative Securities.....	None.....	N/A
(d).....	Call Equivalent Position.....	None.....	N/A
(e).....	Put Equivalent Position.....	None.....	N/A
(f).....	Equity Security of Such Issuer.....	None.....	N/A
(g).....	Officer.....	None.....	N/A
(h).....	Owner of any Security of the Issuer.....	None.....	N/A
16a-2(a).....	Pre-insider Reporting.....	16a-1(d).....	No.
(b).....	Post-insider Reporting.....	16a-1(e).....	No.
(c).....	Transaction Creating 10 Percent Holder.....	None.....	N/A
16a-3(a).....	Forms 3, 4 and 5.....	16a-1(a).....	Yes.
(b).....	Filing Another Form 3.....	16a-1(b).....	No.
(c).....	Copies to Exchange.....	16a-1(c).....	No.
(d).....	Multiple Filings.....	16a-7.....	No.
(e).....	Copies to Issuer.....	None.....	N/A
(f).....	Form 5.....	None.....	N/A
(g).....	Time of Filing.....	None.....	N/A
16a-4.....	Derivative Securities.....	16a-2(b).....	Yes.
16a-5(a)(1).....	Trust 10 Percent Holder.....	16a-8(c).....	No.
(a)(2).....	Insider Trustee.....	None.....	N/A
(a)(3).....	Attribution.....	16a-8(a).....	No.
(a)(4).....	Beneficiary Proportionate Ownership.....	None.....	N/A
(a)(5).....	Persons Also Subject to Sections 16(b) and (c).....	None.....	N/A
(b) and (c).....	Fiduciaries.....	16a-4.....	No.
(d).....	Interests Too Remote.....	16a-8(g).....	Yes.
16a-6.....	Small Acquisitions.....	16a-9.....	Yes.
16a-7.....	Distributions.....	16b-2.....	Yes.
16a-8.....	Intra-Trust Transactions.....	16a-8(b).....	Yes.
16a-9.....	Odd-lot Dealers.....	16a-5.....	No.
16a-10.....	Exemption from Section 16(b).....	16a-10.....	No.
16b-1(a).....	Investment Companies.....	16b-1.....	No.
(b).....	Utility Holding Companies.....	16b-4.....	No.
(c).....	Railroads.....	16b-10.....	No.
16b-2.....	Subscription.....	16b-11.....	No.
16b-3(a).....	Tenders to Issuer.....	16b-3.....	No.
16b-3(b).....	Disinterested Administration.....	16b-3(a).....	Yes.
(c).....	Definitions.....	16b-3(d).....	Yes.
(d).....	SARs.....	16b-3(e).....	No.
16b-4.....	Redemptions.....	16b-5.....	No.
16b-5.....	Gifts and Inheritance.....	16a-9(b).....	Yes.
16b-6(a).....	Derivative Security Purchase/Sale.....	None.....	N/A
(b).....	Conversions/Exercises.....	16b-9.....	Yes.
(c).....	Mergers.....	16b-6(c).....	No.
(d).....	Formula.....	16b-6(b).....	Yes.
(e).....	Expiring Short Position Profit.....	None.....	N/A
16b-7.....	Mergers.....	16b-7.....	No.
16b-8.....	Voting Trusts.....	16b-8.....	No.
16b-9.....	DRIPs.....	16a-11.....	No.
16c-1.....	Brokers.....	16c-1.....	No.
16c-2.....	Underwriters.....	16c-2.....	Yes.
16c-3.....	When-issued Securities.....	16c-3.....	No.
16c-4.....	Derivative Securities Short Positions.....	None.....	N/A
16d-1.....	Marketmakers.....	None.....	N/A
30f-1.....	Investment Companies.....	30f-1.....	No.

#### X. Request for Comment

Any interested persons wishing to submit written comments on; the proposed amendments to Rules 16a-1 through 16c-3, Schedule 14A, Forms 10-K, 3 and 4; the addition of a new Rule 16d-1 and a new Form 5; the deletion of

Rule 12h-2 under the Exchange Act; the addition of a new item to Regulation S-K; and the proposed amendments to Rule 30f-1 and Form N-SAR under the Investment Company Act; as well as on other matters that might have an impact on the proposals contained herein, are

requested to do so. In addition, the Commission requests comments on whether any further changes to the Section 16 rules are necessary or appropriate at this time. The Commission also requests comment on whether the proposed rules, if adopted,

would have an adverse effect on competition that is neither necessary nor appropriate in furthering the purposes of the Exchange Act. Comments on this inquiry will be considered by the Commission in complying with its responsibilities under section 23(a) of the Exchange Act.<sup>215</sup>

#### XI Cost—Benefit Analysis

To evaluate the costs and benefits associated with the proposed amendments addressed in this release, the Commission requests commentators to provide views and data as to the costs and benefits associated with these proposals.

It is expected that the proposed amendments to the rules promulgated pursuant to section 16 would decrease significantly the reporting, recordkeeping, and compliance requirements imposed upon reporting persons subject to Section 16 for the following reasons.

Proposed Rule 16a-1(e) would define the term "officer" for purposes of section 16 in the same manner that "executive officer" currently is defined in Rule 3b-7. The proposed definition reflects concerns that the current definition of "officer" is over-broad and extends to some employees that do not have significant managerial or policy-making duties.

Proposed Rule 16a-1(a)(1) would state that for purposes of determining who is a ten percent beneficial owner only the rules under section 13(d) of the Exchange Act shall apply. Furthermore, proposed Rule 16a-4(a) would deem derivative securities to be of the same class of equity securities as the underlying securities and not a separate class of equity securities for purposes of determining ten percent beneficial ownership. Finally, proposed Rule 16a-1(c) would exclude derivative securities awarded pursuant to an employee benefit plan satisfying proposed Rule 16b-3, if exercisable solely for cash.

Proposed Rule 16a-3(f) would provide a reporting deferral for all trades exempted pursuant to rules promulgated under section 16(b), small acquisitions of securities, stock splits and stock dividends. Under the current rules, trades entitled to reporting deferrals must be reported in the first Form 4 filed by the insider subsequent to the exempted transaction. Under the proposed rules, the deferred period generally would be longer; all trades entitled to reporting deferrals except those falling under the small acquisitions deferral category only

would be reported by the insider at the same time, within 30 days after the registrant's fiscal year end, on a Form 5.

Proposed Rule 16a-7 would provide a reporting exclusion for insider underwriters regarding trades associated with a distribution. Elimination of the need for insider underwriters to participate equally with non-insider underwriters in a distribution also is proposed.

Proposed Rule 16b-6(b) generally would exempt from section 16(b) exercises and conversions of derivative securities.

Proposed Rule 16b-5 would exempt from section 16(b) all acquisitions and dispositions via bona fide gifts regardless of their size. Current Rule 16a-9 provides such an exemption only for bona fide gifts under \$10,000. Proposed Rule 16b-5 also would exempt from section 16(b) all acquisitions and dispositions via the laws of descent.

Proposed Rule 16c-4 would provide that selling a derivative security short or purchasing a put option is not prohibited under section 16 if the securities underlying the derivative security or put option do not exceed the amount of underlying securities otherwise owned. This exemption would become unavailable when a person sells underlying securities such that the securities underlying the derivative securities sold short exceed the amount of underlying securities otherwise owned. As a result of the proposal, put equivalent positions will be deemed violations of section 16(c) in certain circumstances. The current rules prohibit insiders from maintaining short positions in equity securities at any time.

The following proposed amendments may increase the reporting, recordkeeping, and compliance requirements imposed upon reporting persons subject to section 16. It is expected, however, as stated above, that the overall effect of the proposed amendments would be to decrease significantly the impact of such requirements upon reporting persons.

Under current Rule 16a-8(e) with respect to trustees and proposed Rule 16a-1(b), an insider is deemed to be the beneficial owner of securities owned by members of the insider's immediate family sharing the same residence. The current definition of "immediate family" in Rule 16a-8 would be broadened by proposed Rule 16a-1(b) to apply throughout Section 16 and to include siblings, fathers-in-law, mothers-in-law, sons-in-law, daughters-in-law, brothers-in-law, and sisters-in-law, as well as children, grandchildren, stepchildren, parents, stepparents, and spouses.

Current Rule 16a-8(c), which deems the trustee of a trust holding ten percent of a class of equity securities to be a reporting person for purposes of section 16, would be expanded by proposed Rule 16a-5(a)(2). Under the proposed rule, a trust would report not only when it is a ten percent holder, but also when the trustee is an insider. Furthermore, the exemption from section 16(a) provided in current Rule 16a-8(b) for beneficial ownership of securities solely as settlor or beneficiary or a trust where less than 20 percent in market value of the trust consists of the registrant's securities would be deleted. Section III.A.5.a of the release discusses proposed Rule 16a-5 as well as the proposed modifications of current Rule 16a-8(b).

Proposed Rule 16a-3(a) would require all reporting persons subject to section 16 to file an annual reconciliation of beneficial holdings on Form 5. This requirement would increase the burden on reporting persons, particularly those who had no transactions during the year that otherwise would have been reportable on Form 4.

Proposed Rule 16a-3(e) would require insiders to forward copies of their Forms 3, 4 and 5 to the registrant's corporate secretary or other person designated to receive such filings.

Proposed Rule 16b-6(a) would clarify that a derivative security confers beneficial ownership in the underlying security for purposes of section 16(b).

The proposed amendments should not result in any substantial increase in the compliance requirements imposed upon companies registered pursuant to section 12 of the Exchange Act or whose securities are for any other reason subject to section 16. The proposed addition of a new Item 405 to Regulation S-K, triggered by Item 7 of Schedule 14A, Item 10 of Form 10-K and sub-item 88.E of Form N-SAR, would require registrants to describe their procedures for assisting insider compliance with sections 16(a) and 16(b) and report certain information regarding the non-compliance of their insiders with the reporting requirements of section 16(a). In order to fulfill their disclosure obligations, registrants would have to review the Form 3, 4, and 5 reports filed by their insiders. The proposed requirements should not place a significant burden on registrants since reporting persons would be required to send copies of all their Form 3, 4, and 5 reports to the registrants as well as to the Commission. Furthermore, Item 12 of Form 10-K already requires registrants to monitor annually the security

<sup>215</sup> 15 U.S.C. 78w(a) (1982).

holdings of officers, directors, and five percent security holders.

The Commission's proposal to eliminate entirely the current provision in Rule 16b-3(a) requiring shareholder approval of compensation plans and any material amendments thereto should decrease the burdens imposed on companies by section 16. The benefit of the deletion of the shareholder approval requirement would be offset to some extent, however, by the strengthened disinterested administration requirement in proposed Rule 16b-3(b).

## XII. Summary of Initial Regulatory Flexibility Analysis

An Initial Regulatory Flexibility Analysis in accordance with 5 U.S.C. 603 has been prepared concerning the proposed amendments to Rules 16a-1 through 16c-3, Schedule 14A, Forms 10-K, 3 and 4; the addition of a new Rule 16d-1 and a new Form 5; the deletion of Rule 12h-2 under the Exchange Act, as well as the addition of a new item to Regulation S-K. Also a subject of this analysis are proposed amendments to Rule 30f-1 and Form N-SAR under the Investment Company Act. The analysis notes that the proposed amendments are intended to help assure that persons meet their reporting obligations and to ensure the fair and effective operation of section 16(b) by limiting the opportunities for abuse and removing transactions that do not involve the potential for abuse from the scope of the rules.

As discussed more fully in the analysis, many of the reporting persons the proposed amendments would affect are small entities, as defined by the Commission's rules.

It is expected that the overall effect of the proposed amendments would be to decrease significantly the impact of reporting, recordkeeping, and compliance requirements upon reporting persons subject to section 16, although certain of the proposed amendments may increase such requirements, as noted in the analysis.

The analysis discusses several possible significant alternatives to the proposed amendments including, among others, establishing different compliance or reporting requirements for small entities or exempting them from all or part of the proposed requirements. As discussed more fully in the analysis implementing any of these alternatives either would be duplicative of the proposed amendments or would not be consistent with the Exchange Act.

Comments are encouraged on any aspect of the analysis. A copy of the analysis may be obtained by contacting Brian J. Lane or Mark W. Green, Office

of Disclosure Policy, Division of Corporation Finance, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549.

## XIII. Statutory Basis

The amendments to the proxy rules and section 16 rules are being proposed by the Commission pursuant to Exchange Act sections 3(a)(11), 3(b), 9(b), 10(a), 12(h), 13(a), 14, 16, and 23(a). The amendments to the section 30 rule are being proposed pursuant to Investment Company Act of 1940 section 38.

## List of Subjects in 17 CFR Parts 229, 240, 249, 270, and 274

Reporting and recordkeeping requirements, Securities.

## XIV. Text of Proposals

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

### PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S-K

1. The authority citation of Part 229 continues to read:

**Authority:** Secs. 6, 7, 8, 10, 19(a), 48 Stat. 78, 79, 81, 85; secs. 12, 13, 14, 15(d), 23(a), 48 Stat. 892, 894, 901; secs. 205, 209, 48 Stat. 906, 908; sec. 203(a), 49 Stat. 704; secs. 1, 3, 8, 49 Stat. 1375, 1377, 1379; sec. 301, 54 Stat. 857; secs. 8, 202, 68 Stat. 685, 686; secs. 3, 4, 5, 6, 78 Stat. 565-568, 569, 570-574; sec. 1, 79 Stat. 1051; secs. 1, 2, 3, 82 Stat. 454, 455; secs. 1, 2, 3-5, 28(c), 84 Stat. 1435, 1497; sec. 105(b), 88 Stat. 1503; secs. 8, 9, 10, 11, 18, 89 Stat. 117, 118, 119, 155; 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77l, 78m, 78n, 78(d), 78w(a), unless otherwise noted.

2. Section 229.405 is added to Subpart 229.400 to read as follows:

#### § 229.405 (Item 405) Compliance with Section 16(a) of the Exchange Act.

Every person having a class of equity securities registered pursuant to section 12 of the Exchange Act, every closed-end investment company registered under the Investment Company Act of 1940 [15 U.S.C. 80a-1 *et seq.*] and every holding company registered pursuant to the Public Utility Holding Company Act of 1935 [15 U.S.C. 79 *et seq.*] shall:

(a) Describe briefly its procedures for assisting directors, officers, beneficial owners of more than ten percent of any class of equity securities of the registrant, and any other person subject to section 16 of the Exchange Act

because of the requirements of section 30 of the Investment Company Act or of section 17 of the Public Utility Holding Company Act, in complying with sections 16(a) and 16(b) of the Exchange Act; and

(b) Based on a review of the Forms 3, 4, and 5 provided to the registrant concerning transactions conducted during the fiscal year, list each such director, officer, beneficial owner and other person who failed to file any form required by section 16(a) of the Exchange Act in a timely manner. For each such filer, the registrant also shall disclose the number of times that filing was not timely.

### PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read:

**Authority:** Sec. 23, 48 Stat. 901, as amended (15 U.S.C. 78w).

#### § 240.12h-2 [Removed]

2. Section 240.12h-2 is removed.

3. By amending § 240.14a-101 by adding a paragraph (h) before the concluding text to Item 7 to read as follows:

#### § 240.14a-101 Schedule 14A. Information required in proxy statement.

\* \* \* \* \*

#### Item 7. Directors and Executive Officers

\* \* \* \* \*

(h) The information required by Item 405 of Regulation S-K (§ 229.405 of this chapter).

\* \* \* \* \*

4. Sections 240.16a-1 through 240.16a-10 and the undesignated center heading preceding them are revised and § 240.16a-11 is removed, as follows:

#### Reports of Directors, Officers, and Principal Shareholders

#### § 240.16a-1 Definitions.

All terms defined in this rule shall be used only for purposes of section 16 of the Act. These terms shall not be limited to section 16(a) but shall apply to all subsections under section 16.

(a) Beneficial Ownership.

(1) Solely for purposes of determining who is a ten percent beneficial owner, the term "beneficial owner" shall mean any person who is deemed a ten percent beneficial owner by operation of the rules under section 13(d) of the Act.

(2) For all other purposes, the term "beneficial owner" shall mean any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares a pecuniary

interest in the subject securities. A person shall be deemed the beneficial owner of securities:

(i) That such person has the right to acquire through the exercise or conversion of any derivative security, whether it is presently exercisable or not;

(ii) That are held by any member of the immediate family sharing the same residence as the person; or

(iii) That are held by a general partnership, in proportion to that person's partnership interest.

(3) Where more than one person is deemed to be a beneficial owner of the same equity securities, both persons must report as beneficial owners of the securities. In such cases, short swing profit recovery would not be increased over what would otherwise be recoverable if there were only one beneficial owner.

(4) Any person filing a statement may declare expressly therein that the filing of such statement shall not be construed as an admission that such person is, for the purpose of section 16 of the Act, the beneficial owner of any equity securities covered by the statement, unless beneficial ownership is otherwise mandated by § 240.16a-1(a).

(b) The term "immediate family" shall mean any child, stepchild, grandchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law. For the purpose of determining whether any of the foregoing relations exist, a legally adopted child of a person shall be considered a child of such person by blood.

(c) The term "derivative securities" shall mean any option, warrant, convertible security, stock appreciation right, or other similar right related to an equity security, but shall not include:

(1) The right of a pledgee of securities to sell the pledged securities;

(2) The right to acquire or the obligation to sell securities in connection with a merger, exchange offer, or consolidation involving the issuer of the securities;

(3) Securities awarded pursuant to an employee benefit plan satisfying § 240.16b-3 that can be exercised only for cash and permit no discretion as to whether to receive another form of equity security in lieu of cash; and

(4) Broad-based index options and broad-based index futures.

(d) The term "call equivalent position" shall mean a derivative security position that increases in value as the value of the underlying equity increases, including, but not limited to, a long

convertible security, long call option, and short put option position.

(e) The term "put equivalent position" shall mean a derivative security position that increases in value as the value of the underlying equity decreases, including, but not limited to, a long put option and a short call option position.

(f) The term "equity security of such issuer" shall mean any equity security or derivative security of or relating to a particular issuer, whether or not issued by that issuer.

(g) The term "officer" shall mean a registrant's president, any vice-president of the registrant in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function or any other person who performs similar policy-making functions for the registrant. Officers of subsidiaries may be deemed officers of the registrant if they perform such policy-making functions for the registrant. In addition, when the registrant is a limited partnership, officers or employees of the general partners with policy-making functions are deemed officers of the registrant.

(h) The term "owner of any security of the issuer" for purposes of section 16 of the Act shall mean a beneficial owner of securities of the issuer at the time of suit or, if as a result of a business combination the issuer, at the time of suit, does not have a reporting obligation under section 13 or 15(d) of the Act with respect to an equity security, a former beneficial owner of the issuer who was required to surrender such securities due to such business combination.

#### § 240.16a-2 Persons subject to section 16.

All directors, officers, and persons who are the beneficial owners of more than 10 percent of a class of equity securities of an issuer registered pursuant to section 12 of the Act shall be subject to the provisions of section 16, subject to the following:

(a) Any director or officer who is required to file a statement on Form 4 with respect to any change in beneficial ownership of equity securities which occurs within 6 months after becoming a director or officer of the issuer of such securities, or within 6 months after equity securities of such issuer first became registered pursuant to section 12 of the Act, shall include in the first such statement the information called for by Form 4 with respect to all changes in beneficial ownership of equity securities of such issuer which occurred within 6 months prior to the date of the changes which require the filing of such statement.

(b) Any person who has ceased to be a director or officer of an issuer that has equity securities registered pursuant to section 12 of the Act, or who is a director or officer of an issuer at the time it ceased to have any equity securities so registered, shall file a statement on Form 4 with respect to any change in beneficial ownership of equity securities of such issuer that shall occur on or after the date on which such person ceased to be such director or officer or the date on which the issuer ceased to have any equity securities so registered if such change shall occur within 6 months after any change in such person's beneficial ownership of such securities prior to such date.

(c) The transaction that results in a person becoming a 10 percent beneficial owner need not be reported unless the person already is required to file reports concerning securities of that issuer in another capacity. A 10 percent beneficial owner must report only those transactions conducted while holding at least 10 percent of any class of equity securities.

#### § 240.16a-3 How to report.

(a) Initial statements of beneficial ownership of equity securities required by section 16(a) of the Act shall be filed on Form 3 (§ 249.103 of this chapter). Statements of changes in such beneficial ownership required by the section shall be filed on Form 4 (§ 249.104). Annual statements of reconciliation shall be filed on Form 5 (§ 249.105). All such statements shall be prepared and filed in accordance with the requirements of the applicable form.

(b) A person who already is filing statements pursuant to section 16(a) of the Act with respect to equity securities registered pursuant to either section 12 (b) or (g) of the Act need not file an additional statement on Form 3 (§ 249.103):

(1) When an additional class of equity securities of the same issuer becomes registered pursuant to the same section of the Act; or

(2) When such person assumes a different or an additional relationship to the same issuer; for example, when an officer becomes a director,

(c) Any issuer that has equity securities listed on more than one national securities exchange may designate one such exchange as the only exchange with which reports pursuant to section 16(a) of the Act need be filed. Such designation shall be made in writing and shall be filed with the Commission and with each national securities exchange on which any equity

security of the issuer is listed. The obligation to file with each national securities exchange on which any equity security of the issuer is listed shall be satisfied by filing with the designated exchange.

(d) Any person required to file a statement under both section 16(a) of the Act and section 17(a) of the Public Utility Holding Company Act of 1935 or section 30(f) of the Investment Company Act of 1940 may file a single statement containing the required information which will be deemed to be filed under both Acts. To comply with the requirement of section 16(a), where applicable, that statements be filed with national securities exchanges, a duplicate original of such statement shall be filed with such exchanges or with the exchange designated pursuant to § 240.16a-3(c).

(e) Any person required to file a statement under section 16(a) shall, at the time of filing, send or deliver a duplicate to the registrant's corporate secretary or other person designated by the registrant.

(f) A Form 5 filing shall be required from every person required to file statements under section 16(a) as of the end of the registrant's fiscal year. This statement shall be filed within 30 days of the end of the registrant's fiscal year. This filing shall be required regardless of whether the reporting person is the beneficial owner of any securities or there have been any transactions in the reported securities conducted during the year. All transactions during the fiscal year shall be reported on Form 4, except that the following shall be reported on Form 5:

(1) Changes in ownership resulting from stock splits or stock dividends occurring during the fiscal year;

(2) Small acquisitions during the fiscal year, unless previously reported on Form 4 pursuant to § 240.16a-6;

(3) All transactions conducted during the fiscal year that were exempted by operation of any rule pursuant to section 16(b) of the Act; and

(4) Any occurrence or transaction required to be reported on Form 3 or 4 under section 16(a) of the Act that was required to be filed prior to, and that has yet to be reported as of the date by which the Form 5 is filed; *Provided, however,* that the required Form 3 or 4 shall be appended to the Form 5.

(g) The date of filing with the Commission shall be the date of receipt by the Commission; *Provided, however,* the Form 3, 4 or 5 shall be deemed to have been timely filed if the filing person establishes that the Form had been transmitted to the Commission by first class mail or any equally prompt

means on or before the date on which the filing was due.

#### § 240.16a-4 Derivative securities.

(a) The granting, acquisition or disposition of any derivative security, or any expiration or cancellation thereof shall be deemed to effect a change in the beneficial ownership of the underlying securities to which the derivative security relates. For purposes of section 16 of the Act, both derivative securities and the underlying securities to which they relate shall be deemed to be the same class of equity securities, except that they shall be reported separately.

(b) For reporting purposes, the exercise or conversion of a call equivalent position shall be treated as:

(1) A purchase of the underlying security; and

(2) A closing of the derivative security position.

(c) For reporting purposes, the exercise of a put equivalent position shall be treated as:

(1) A sale of the underlying security; and

(2) A closing of the derivative security position.

*Note.*—Under § 240.16b-6(b), a purchase or sale incident to an exercise or conversion of a derivative security generally is exempt from section 16(b) of the Act.

#### § 240.16a-5 Trusts and remote interests.

(a) The following provisions apply to trusts:

(1) In the event that more than 10 percent of any class of any equity security (other than an exempted security) that is registered pursuant to section 12 of the Act is held in a trust, as determined pursuant to Rule 16a-1(a)(1), both the trust and trustee shall file reports as specified in § 240.16a-3. The trustee shall report on behalf of the trust, and shall report separately transactions on behalf of the trustee as any other person subject to section 16 of the Act.

(2) In the event that a trustee is a person required to file reports pursuant to § 240.16a-3, the trustee shall report on behalf of each trust in which the trustee exercises investment decision-making authority, and also shall report separately transactions on behalf of the trustee.

(3) In the event that the following conditions are met, transactions of a trust will be attributable to a person specified in § 240.16a-2 as well as the trust:

(i) If a person specified in § 240.16a-2 is the trustee and at least one beneficiary of the trust is a member of the trustee's immediate family, all transactions of the trust will be

attributed to the trustee and the trustee shall report the transactions of the trust as transactions of the trustee.

(ii) If a person specified in § 240.16a-2 owns securities as settlor of a trust and has the power to revoke the trust without obtaining the consent of the beneficiaries, all transactions of the trust will be attributed to the settlor and the settlor shall report the transactions of the trust as transactions of the settlor.

(4) If a person specified in § 240.16a-2 owns a vested beneficial interest in a trust, that person shall report the transactions of the trust unless meeting the conditions of § 240.16a-8. The person may report trust transactions in proportion to that person's beneficial interest.

(5) In the event a trust or other person becomes a reporting person pursuant to this rule, it shall likewise be subject to sections 16 (b) and (c) of the Act.

*Note.*—Transactions by a trustee on behalf of a settlor or beneficiary without such person's prior approval or direction need not be reported by such person, as specified in § 240.16a-8.

(b) A trustee is exempt from the provisions of section 16(a) under the Act for the 12 months following its appointment and qualification, to the extent the trustee is acting as:

(1) Executor or administrator of the estate of a decedent;

(2) Guardian or member of a committee for an incompetent; or

(3) Receiver, trustee in bankruptcy, assignee for the benefit of creditors, conservator, liquidating agent, or other similar person duly authorized by law to administer the estate or assets of another person.

(c) After the 12 month period following its appointment or qualification, a trustee previously exempt pursuant to paragraph (b) of this rule must report and be liable for all transactions of the estate being administered only where the estate is a beneficial owner of more than 10 percent of any class of equity security (other than an exempt security) that is registered pursuant to section 12 of the Act.

(d) The following interests are considered too remote to confer beneficial ownership for purposes of section 16(a) of the Act, notwithstanding the provisions of Rule 16a-1(a)(2):

(1) The remainder interest of a trust;

(2) Indirect interests in portfolio securities held by:

(i) Any holding company registered under the Public Utility Holding Company Act;

(ii) Any investment company registered under the Investment Company Act; and

(iii) A pension or retirement plan holding securities of an issuer whose employees generally are the beneficiaries of the plan.

#### § 240.16a-6 Small acquisitions.

(a) Any acquisition that does not exceed \$10,000 in market value is permitted to be reported on either a Form 4 or Form 5 (whichever is required to be filed first), subject to the following conditions:

(1) Total acquisitions of securities of the same class (including derivative securities) within the prior six months do not exceed \$10,000 in market value; and

(2) The person effecting the acquisition does not within six months thereafter effect any disposition, other than by a transaction exempted from section 16(b) of the Act.

(b) Should an acquisition no longer qualify for the reporting deferral in paragraph (a) of this rule, all such acquisitions that have not yet been reported shall be reported on a Form 4 within 10 days after the close of the calendar month in which the conditions of paragraph (a) no longer are met.

#### § 240.16a-7 Transactions effected in connection with a distribution.

(a) Any transaction of purchase and sale, or sale and purchase, of a security which is effected in connection with the distribution of a substantial block of securities shall be exempt from the provisions of section 16(a) of the Act, to the extent specified in this rule, as not comprehended within the purpose of said section, upon the following conditions:

(1) The person effecting the transaction is engaged in the business of distributing securities and is participating in good faith, in the ordinary course of such business, in the distribution of such block of securities; and

(2) The security involved in the transaction is:

(i) A part of such block of securities and is acquired by the person effecting the transaction, with a view to the distribution thereof, from the issuer or other person on whose behalf such securities are being distributed or from a person who is participating in good faith in the distribution of such block of securities; or

(ii) A security purchased in good faith by or for the account of the person effecting the transaction for the purpose of stabilizing the market price of securities of the class being distributed

or to cover an over-allotment or other short position created in connection with such distribution.

(b) Each person participating in the transaction must qualify on an individual basis for an exemption pursuant to this rule.

#### § 240.16a-8 Intra-trust transactions.

Transactions on behalf of a settlor or beneficiary within a trust conducted by the trustee without the prior approval or direction of the settlor or beneficiary, are exempt from the provisions of section 16(a) of the Act. This exemption does not extend to distributions from a trust.

#### § 240.16a-9 Odd-lot dealers.

Securities purchased or sold by an odd-lot dealer in odd lots as reasonably necessary to carry on odd-lot transactions or in round lots to offset odd-lot transactions previously or simultaneously executed or reasonably anticipated in the usual course of business, shall be exempt from the provisions of section 16(a), with respect to participation by such odd-lot dealer in such transaction.

#### § 240.16a-10 Exemptions under section 16(a).

Except as provided in § 240.16a-6, any transaction which has been or shall be exempted by the Commission from the requirements of section 16(a) shall, insofar as it is otherwise subject to the provisions of section 16(b), be likewise exempted from section 16(b).

5. Sections 240.16b-1 through 240.16b-9 are revised, §§ 240.16b-10 and 240.16b-11 are removed and the undesignated center heading preceding them is republished to read as follows:

**Note:** Two alternatives are proposed for § 240.16b-6(d).

#### Exemption of Certain Transactions From Section 16(b)

##### § 240.16b-1 Transactions approved by regulatory authority.

(a) Any purchase and sale, or sale and purchase, of a security shall be exempt from the operation of section 16(b) of the Act, if the transaction is effected by an investment company registered under the Investment Company Act of 1940 and both the purchase and sale of such security have been exempted from the provisions of section 17(a) of that Act by rule or order of the Commission entered pursuant to section 17 of the Act.

(b) Any purchase and sale, or sale and purchase, of a security shall be exempt from the provisions of section 16(b) of the Act if:

(1) The person effecting such transaction is either a holding company

registered under the Public Utility Holding Company Act of 1935 or a subsidiary thereof; and

(2) Both the purchase and the sale of such security have been approved or permitted by the Commission pursuant to the applicable provisions of that Act or the rules and regulations thereunder.

(c) Any acquisition of securities made in exchange for other securities shall be exempt from the provisions of section 16(b) of the Act if:

(1) The securities are acquired from the issuer;

(2) The person acquiring the securities is subject to one or more of the provisions of Part I of the Interstate Commerce Act;

(3) The person acquiring the securities is:

(i) Subject to an order of, or has accepted a condition imposed by, the Interstate Commerce Commission in an approval of a unification, merger or acquisition of control pursuant to section 5(2) of the Interstate Commerce Act, requiring such person to dispose of all securities of the same class as those exchanged for the securities acquired; and

(ii) The issuance of the securities acquired by such person has been approved by the Interstate Commerce Commission pursuant to section 20(a) of the Interstate Commerce Act; and

(4) The person acquiring voting equity securities has transferred all voting rights on an unrestricted basis to one or more banks and such transfer remains in effect until such securities are disposed of by such person.

##### § 240.16b-2 Subscription rights.

(a) Any sale of a subscription right to acquire any subject security of the same issuer shall be exempt from the provisions of section 16(b) of the Act if:

(1) Such subscription right is acquired, directly or indirectly, from the issuer without the payment of consideration;

(2) Such subscription right by its terms expires within 45 days after the issuance thereof;

(3) Such subscription right by its terms is issued on a pro rata basis to all holders of the beneficiary security of the issuer; and

(4) A registration statement under the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) is in effect as to each subject security, or the terms of any exemption from such registration have been met in respect to each subject security.

(b) When used within this Section the following terms shall have the meaning indicated:

(1) The term "subscription right" means any warrant or certificate

evidencing a right to subscribe to or otherwise acquire an equity security;

(2) The term "beneficiary security" means a security registered pursuant to section 12 of the Act to the holders of which a subscription right is granted; and

(3) The term "subject security" means a security that is the subject of a subscription right.

(c) Notwithstanding anything contained herein to the contrary, if a person purchases subscription rights for cash or other consideration, then a sale by such person of subscription rights otherwise exempted by this Section will not be so exempted to the extent of such purchases for consideration within the 6-month period preceding or following such sale.

#### § 240.16b-3 Benefit plans.

(a) *Exempt transactions.* The following transactions by a director or officer shall be exempt from the operation of section 16(b) of the Act if they occur pursuant to a plan which satisfies the conditions of this rule:

(1) The acquisition of an option, warrant, right, or shares of stock;

(2) The expiration, cancellation or surrender to the issuer of a stock option or stock appreciation right; and

(3) The surrender or delivery to the issuer of shares of its stock as payment for the exercise of an option, warrant or right with respect to shares of the same class.

(b) *Disinterested administration.* (1) The plan shall satisfy one of the following conditions:

(i) The plan is administered solely by a committee of directors, the majority of which are disinterested persons; or

(ii) The plan by its terms:

(A) Predetermines which officers and directors may receive grants;

(B) Predetermines the timing of the grants for all participants;

(C) Predetermines the amount of securities to be granted to individual participants (which shall be governed by a formula or standardized criteria for all participants, such as earnings of the issuer, value of the securities, years of service, etc.);

(D) Provides that no discretion, concerning the administration of the plan, shall be afforded to a person who is not a disinterested person; and

(E) Provides that the requirements described in paragraph (b)(1)(ii) (A) through (C) of this section shall not be amended more than once every six months.

(2) Compliance with this paragraph shall not be necessary with respect to any option or right granted, or other equity security acquired, prior to the

date of the first registration of an equity security under section 12 of the Act.

(3) Plans that permit participation of persons other than those subject to section 16 of the Act need not comply with this paragraph regarding administration of the plan as it relates to those persons not subject to Section 16 of the Act.

(c) *Definitions.* Unless the context otherwise requires, all terms used in this rule shall have the same meaning as in the Act, the General Rules and Regulations thereunder, or the Rules under this section 16. In addition, the following definitions apply:

(1) The term "plan" shall mean an option, bonus, appreciation, profit sharing, retirement, incentive, thrift, savings or similar plan that meets the following conditions:

(i) The plan must be set forth in a written document describing the means or basis for determining the eligibility of individuals to participate and either the price at which the securities may be offered or the method by which the price or the amount of the award is to be determined; and

(ii) The plan must provide, with respect to any option or similar right (including a stock appreciation right) offered pursuant to the plan, that such option or right is not transferable other than by will or the laws of descent and distribution, and that it is exercisable during the employee's lifetime only by the employee or the employee's guardian or legal representative, but not for at least six months after grant, unless death or disability of the grantee occurs before the expiration of the six-month period.

(2) The term "exercise of an option, warrant or right" contained in paragraph (a) of this section shall not include:

(i) The making of an election to receive under any plan compensation in the form of stock or credits therefor, provided that such election is made either prior to the making of the award or prior to the fulfillment of all conditions to the receipt of the compensation and, provided further, that such election is irrevocable until at least six months after termination of employment;

(ii) The subsequent crediting of such stock;

(iii) The making of any election as to the time for delivery of such stock after termination of employment, provided that such election is made at least six months prior to any such delivery;

(iv) The fulfillment of any condition to the absolute right to receive such stock; or

(v) The acceptance of certificates for shares of stock.

(3) The term "disinterested person" used in paragraph (b) of this rule shall mean an administrator of a plan who

(i) During one year prior to the time of exercising discretion in administering the plan, the person has not been eligible for selection as a person to whom equity securities may be allocated or granted pursuant to the plan (or any other plan of the issuer or any of its affiliates) entitling the participants therein to acquire equity securities; and

(ii) Is not so eligible for three years after such exercise; *provided, however*, that a disinterested person may participate in a plan that satisfies the conditions of paragraph (b)(1)(ii) of this section if awards are not subject to the discretion of any person.

(d) *Cash Settlements of Stock Appreciation Rights.* Any transaction involving the exercise and cancellation of a stock appreciation right issued pursuant to a plan (whether or not the transaction also involves the related surrender and cancellation of a stock option), and the receipt of cash in complete or partial settlement of that right, shall be exempt from the operation of section 16(b) of the Act, as not comprehended within the purpose of that section, if all the following conditions are met:

(1) *Information about the issuer.* (i) The issuer of the stock appreciation right has been subject to the reporting requirements of section 13 of the Act for at least a year prior to the transaction and has filed all reports and statements required to be filed pursuant to that section during that year.

(ii) The issuer of the stock appreciation right on a regular basis does release for publication quarterly and annual summary statements of sales and earnings. This condition shall be deemed satisfied if the specified financial data appears—

(A) on a wire service,

(B) in a financial news service,

(C) in a newspaper of general circulation, or

(D) is otherwise made publicly available.

(2) *Administration of the plan.* (i) The plan shall be administered in the manner specified in paragraph (b)(1)(i) of this section.

(ii) The board or committee shall have sole discretion either

(A) to determine the form in which payment of the right will be made (i.e., cash, securities, or any combination thereof) or

(B) to consent to or disapprove the election of the participant to receive cash in full or partial settlement of the

right. Such consent or disapproval may be given at any time after the election to which it relates.

(iii) Any election by the participant to receive cash in full or partial settlement of the stock appreciation right, as well as any exercise by the participant of the stock appreciation right for such cash, shall be made during the period beginning on the third business day following the date of release of the financial data specified in paragraph (d)(1)(ii) of this section and ending on the twelfth business day following such date. This paragraph (d)(3)(iii) of this section, however, shall not apply to any exercise by the participant of a stock appreciation right for cash where the date of exercise:

(A) Is automatic or fixed in advance under the plan; and

(B) Is outside the control of the participant.

#### § 240.16b-4 Issuer redemptions.

Any acquisition of an equity security (other than a convertible security or right to purchase a security) by a director or officer of the issuer of such security shall be exempt from the operation of section 16(b) upon condition that:

(a) The equity security is acquired by way of redemption of another security of an issuer, substantially all of whose assets other than cash (or government bonds) consist of securities of the issuer of the equity security so acquired;

(b) The acquired equity security:

(1) Represented substantially and in practical effect a stated or readily ascertainable amount of such equity security;

(2) Had a value which was substantially determined by the value of the redeemed equity security; and

(3) Conferred upon the holder the right to receive the acquired equity security without the payment of any consideration other than the security redeemed;

(c) No security of the same class as the security redeemed was acquired by the director or officer within six months prior to such redemption or is acquired within six months after such redemption; and

(d) The issuer of the acquired equity security has recognized the applicability of paragraph (a) of this section by appropriate corporate action.

#### § 240.16b-5 Bona fide gifts and inheritance.

Both acquisitions and dispositions of equity securities shall be exempt from the operation of section 16(b) if they are:

(a) Bona fide gifts; or

(b) Transfers of securities by will or the laws of descent and distribution.

#### § 240.16b-6 Derivative securities.

(a) The establishment of or increase in a call equivalent position or liquidation of or decrease in a put equivalent position shall be deemed a purchase of the underlying security for purposes of section 16(b) of the Act, and the establishment of or increase in a put equivalent position or liquidation of or decrease in a call equivalent position shall be deemed a sale of the underlying securities for purposes of section 16(b) of the Act.

(b) The closing of a derivative security position as a result of its exercise shall be exempt from the operation of section 16(b) of the Act, and the acquisition of underlying securities due to the exercise or conversion of a call equivalent position or the disposition of underlying securities due to the exercise of a put equivalent position shall be exempt from the operation of section 16(b) of the Act; *Provided, however*, that the acquisition or disposition of securities from the exercise of an out-of-the-money option, warrant, or right shall not be exempt.

(c) The disposition of a security received from the exercise of a derivative security awarded pursuant to a plan satisfying § 240.16b-3 shall be exempt from the provisions of section 16(b) if the disposition is pursuant to a plan or agreement for merger or consolidation, or reclassification of the issuers' securities, or for the exchange of its securities for the securities of another person which has acquired its assets, or which is in control, as defined in section 368(c) of the Internal Revenue Code of 1986, of a person which has acquired its assets, where the terms of such plan or agreement are binding upon all stockholders of the issuer except to the extent that dissenting stockholders may be entitled, under statutory provisions of provisions contained in the certificate of incorporation, to receive the appraised or fair value of their holdings.

#### Alternative A

(d) In determining the short-swing profit recoverable pursuant to section 16(b) of the Act from transactions involving the purchase and sale or sale and purchase of derivative and underlying securities the following rules apply:

(1) Short-swing profits in transactions involving the purchase and sale or sale and purchase of derivative securities that have identical characteristics (*e.g.*, purchases and sales of call options of the same strike price and expiration date, or purchases and sales of the same

series of convertible debentures) shall be measured by the actual prices paid or received in the short-swing transactions.

(2) Short-swing profits in transactions involving the purchase and sale or sale and purchase of derivative securities having different characteristics (*e.g.*, the purchase of a call option and the sale of convertible debenture) or derivative securities and underlying securities shall not exceed the difference in price of the underlying security from the time of purchase or sale to the time of sale or purchase. Such profits may be approximated by measuring the short-swing profits that would have been realized had the subject transactions involved purchases and sales solely of the derivative security that was actually purchased or solely of the derivative security that was actually sold, valued as of the time of the matched purchase or sale, and calculated for the lesser of the number of ultimate underlying securities covered by the derivative security actually purchased or sold.

(3) Short-swing profits shall, to the extent practicable and necessary in order to provide an equitable measure of short-swing profit, be measured through the application of valuation techniques that adjust the measure of short-swing profit recovery to account for changes in—

(i) The price of the underlying equity.

(ii) The volatility of the underlying equity.

(iii) Prevailing interest rates,

(iv) The strike price, conversion price or conversion ratio of the derivative security

(v) The time to expiration of the derivative security, as well as

(vi) Any other factors that the court may deem relevant.

#### Alternative B

(d) In determining the short-swing profit recoverable, pursuant to section 16(b) of the Act, from the purchase and sale or sale and purchase of two different types of derivative securities or of derivative securities and underlying equity securities, the following rules apply:

(1) In the absence of a contrary judicial determination pursuant to paragraph (d)(2) of this section, the measure of short-swing profit liability shall be the difference in price of the underlying security from the time of purchase or sale to the time of sale or purchase.

(2) Nothing in this rule shall preclude courts from using valuation methods that are different than those contained in this rule, when the facts so require in

order to provide an equitable measure of profit.

(e) Any profit derived from writing an option upon expiration of the option, where the expiration was within six months of the writing of the option, shall be recoverable under section 16(b) of the Act.

#### **§ 240.16b-7 Mergers, reclassifications, and consolidations.**

(a) The following transactions shall be exempt from the provisions of section 16(b):

(1) The acquisition or disposition of a security of a company, pursuant to a merger or consolidation, in exchange for a security of a company which, prior to said merger or consolidation, owned 85 percent or more of the equity securities of all other companies involved in the merger or consolidation (except in the case of consolidation, owned 85 percent of the resulting company); or

(2) The acquisition or disposition of a security of a company, pursuant to a merger or consolidation, in exchange for a security of a company which, prior to said merger or consolidation, held over 85 percent of the combined assets of all the companies undergoing merger or consolidation, computed according to their book values prior to the merger or consolidation as determined by reference to their most recent available financial statements for a 12 month period prior to the merger or consolidation.

(b) A merger within the meaning of this rule shall include the sale or purchase of substantially all the assets of one company by another in exchange for stock which is then distributed to the security holders of the company that sold its assets.

(c) Notwithstanding the foregoing, if an officer, director or stockholder shall make any purchase (other than a purchase exempted by a rule under section 16(b) of the Act) of a security in any company involved in the merger or consolidation and any sale (other than a sale exempted by a rule under section 16(b) of the Act) of a security in any other company involved in the merger or consolidation within any period of less than 6 months during which the merger or consolidation took place, the exemption provided by this rule shall be unavailable.

#### **§ 240.16b-8 Voting trusts.**

Any acquisition or disposition of an equity security or certificate involved in the deposit or withdrawal from a voting trust or deposit agreement shall be exempt from the operation of section 16(b) of the Act if substantially all of the assets held under the voting trust or

deposit agreement immediately after the deposit or immediately prior to the withdrawal consisted of equity securities of the same class as the security deposited or withdrawn: *Provided, however,* that this section shall not apply to the extent that there shall have been a purchase or sale of an equity security of the class deposited and a sale or purchase of any certificate representing such equity security (other than the actual deposit or withdrawal) transaction within a period of less than 6 months during which the deposit or withdrawal took place.

#### **§ 240.16b-9 Dividend or interest reinvestment plans.**

Any acquisition of securities resulting from reinvestment of dividends or interest shall be exempt from section 16(b) if it is made pursuant to a plan providing for the regular reinvestment of such dividends or interest; *Provided, however,* that the plan shall be made available on the same terms to all holders of securities of the class on which the reinvested dividends or interest are being paid.

6. Sections 240.16c-1 through 16c-3 are revised, and §§ 240.16c-4 and 16d-1 are added and the undesignated center heading is republished to read as follows:

#### **Exemption of Certain Securities From Section 16(c)**

##### **§ 240.16c-1 Brokers.**

Any security shall be exempt from the operation of section 16(c) of the Act to the extent necessary to render lawful the execution by a broker of an order for an account in which the broker has no direct or indirect interest.

##### **§ 240.16c-2 Transactions effected in connection with a distribution.**

Any security shall be exempt from the operation of section 16(c) of the Act to the extent necessary to render lawful any sale made by or on behalf of a dealer in connection with a distribution of a substantial block of securities, where the sale is represented by an over-allotment in which the dealer is participating as a member of an underwriting group, or the dealer or a person acting on his behalf intends in good faith to offset such sale with a security to be acquired by or on behalf of the dealer as a participant in an underwriting, selling, or soliciting-dealer group of which the dealer is a member at the time of the sale, whether or not the security to be so acquired is subject to a prior offering to existing security holders or some other class of persons.

##### **§ 240.16c-3 Exemption of sales of securities to be acquired.**

(a) Whenever any person is entitled, as an incident to his ownership of an issued security and without the payment of consideration, to receive another security "when issued" or "when distributed," the sale of the security to be acquired shall be exempt from the operation of section 16(c) provided, that:

(1) The sale is made subject to the same conditions as those attaching to the right of acquisition;

(2) Such person exercises reasonable diligence to deliver such security to the purchaser promptly after his right of acquisition matures; and

(3) Such person reports the sale on the appropriate form for reporting transactions by persons subject to section 16(a).

(b) This rule shall not be construed as exempting transactions involving both a sale of a security "when issued" or "when distributed" and a sale of the security by virtue of which the seller expects to receive the "when-issued" or "when-distributed" security, if the two transactions combined result in a sale of more units than the aggregate of those owned by the seller plus those to be received by the seller pursuant to the seller's right of acquisition.

##### **§ 240.16c-4 Derivative securities.**

(a) Establishing or increasing a put equivalent position shall not be prohibited under section 16(c) of the Act, provided that the securities underlying the put equivalent position so transacted do not exceed the amount of underlying securities otherwise owned.

(b) This rule shall become unavailable when a person sells underlying securities such that the securities underlying the put equivalents exceed the amount of underlying securities otherwise owned.

##### **§ 240.16d-1 Market maker reporting.**

Transactions exempt pursuant to section 16(d) of the Act, need not be reported on Forms 3, 4 or 5.

#### **PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934**

1. The authority citation for Part 249 continues to read as follows:

**Authority:** Securities Exchange Act of 1934, 15 U.S.C. 78a, unless otherwise noted.

2. By revising Item 10 of Form 10-K in § 249.310 to read as follows:

**Item 10. Directors and Executive Officers of the Registrant**

Furnish the information required by Items 401 and 405 of Regulation S-K. (§§ 229.401 and 229.405 of this chapter).

3. By revising the last sentence in § 249.104 to read as follows:

**§ 249.104 Form 4, statement of changes in beneficial ownership of securities.**

\* \* \* Failure to disclose the information requested by this form, except for social security account numbers, may result in civil or criminal action against the persons involved for violations of provisions of the Federal securities laws and the rules promulgated thereunder.

4. By adding 249.105 to Subpart B to read as follows:

**§ 249.105 Form 5 annual reconciliation of beneficial ownership of securities.**

(a) This form shall be filed pursuant to Rule 16a-1(a) (17 CFR 240.16a-1(a)) for annual reconciliation of beneficial ownership of securities required to be filed pursuant to section 16(a) of the Securities Exchange Act of 1934. Under sections 16(a) and 23(a) of the Securities Exchange Act of 1934; sections 17(a) and 20(a) of the Public Utility Holding Company Act of 1935; and sections 30(f) and 38 of the Investment Company Act of 1940, and the rules and regulations thereunder, the Commission is authorized to solicit the information required to be supplied by this form by officers, directors and certain security holders of registered issuers.

(b) Disclosure of the information specified in this form is mandatory, except for social security account numbers, disclosure of which is voluntary. The information will be used for the primary purpose of determining and disclosing the holdings of officers, directors and beneficial owners of registered companies. This statement will be made a matter of public record. Therefore, any information given will be available for inspection by any member of the public.

(c) Because of the public nature of the information, the Commission can utilize it for a variety of purposes, including referral to other governmental authorities or securities self-regulatory organizations for investigatory purposes or in connection with litigation involving the Federal securities laws or other civil, criminal or regulatory statutes or provisions. Social security account numbers, if furnished, will assist the Commission in identifying officers, directors and security holders and, therefore, in promptly processing statements of beneficial ownership of securities on this form.

(d) Failure to disclose the information requested by this form, except for social security account numbers, may result in civil or criminal action against the persons involved for violation of

provisions of the Federal securities laws and the rules promulgated thereunder.

5. By revising Forms 3 and 4 and adding a new Form 5.

Note: Forms 3 and 4 are not and Form 5 will not be included in the Code of Federal Regulations [§§ 249.103, 249.104 and 249.105].

**Form 3—Initial Statement of Beneficial Ownership of Securities Special Instructions For Completing Form 3**

Under sections 16(a) and 23(a) of the Securities Exchange Act of 1934; sections 17(a) and 30(a) of the Public Utility Holding Company Act of 1935; and sections 30(f) and 38 of the Investment Company Act of 1940, and the rules and regulations thereunder, the Commission is authorized to solicit the information required to be supplied by this form by officers, directors and certain security holders of a registered issuer.

Disclosure of the information specified in this form is mandatory, except for social security account numbers, disclosure of which is voluntary. The information will be used for the primary purpose of determining and disclosing the holdings of officers, directors and beneficial owners of registered companies. This statement will be made a matter of public record. Therefore, any information given will be available for inspection by any member of the public.

Because of the public nature of the information, the Commission can utilize it for a variety of purposes, including referral to the other governmental authorities or securities self-regulatory organizations for investigatory purposes or in connection with litigation involving the Federal securities laws or other civil, criminal or regulatory statutes or provisions. Social security account numbers, if furnished, will assist the Commission in identifying officers, directors, and security holders and, therefore, in promptly processing initial statements of beneficial ownership of securities.

Failure to disclose the information requested by this form, except for social security account numbers, may result in civil or criminal action against the persons involved for violation of provisions of the Federal securities laws and rules promulgated thereunder.

**General Instructions**

**1. When and Where Statements are To Be Filed**

(a) Within 10 days after the occurrence of any event which requires the filing of the statement on this form, three copies, at least one of which shall be manually signed, shall be filed with

the Securities and Exchange Commission, Washington, DC 20549. The events which require the filing of a statement on this form are set forth in section 16(a) of the Securities Exchange Act of 1934, section 17(a) of the Public Utility Holding Company Act of 1935 and section 30(f) of the Investment Company Act of 1940. At the same time, one duplicate original of the statement shall be filed with each exchange on which any class of equity securities of the company is registered, unless the company has, in accordance with Rule 16a-3(c), designated a single exchange to receive such statements. One duplicate original also shall be filed with the company pursuant to Rule 16a-3(e). The filing date is the date of receipt at the Commission except as otherwise provided by Rule 16a-3(g).

(b) Acknowledgment of receipt of the statement by the Commission may be obtained by enclosing a self-addressed, stamped postal card identifying the statement filed.

**2. Separate Statement for Each Company—Exception**

A separate statement shall be filed with respect to the securities of each company, except that a single statement shall be filed with respect to the securities of a registered public utility holding company and of all of its subsidiary companies.

**3. Date as of Which Information Is To Be Given**

Information as to the amount of securities beneficially owned, including those subject to derivative securities, shall be given as of the date on which the event occurred that requires the filing of the statement on this form.

**4. Classes of Securities To Be Reported**

(a) Persons reporting pursuant to section 16(a) of the Securities Exchange Act of 1934 shall include information as to their beneficial ownership of all classes of equity securities of the company even though one or more of such classes may not be registered pursuant to section 12 of the Act.

(b) Persons reporting pursuant to section 17(a) of the Public Utility Holding Company Act of 1935 shall include information as to their beneficial ownership of all classes of securities of the registered holding company and of all of its subsidiary companies.

(c) Persons reporting pursuant to section 30(f) of the Investment Company Act of 1940 shall include information as to their beneficial ownership of all classes of securities of the registered closed-end investment company (other

than "short-term paper" as defined in section 2(a)(38) of the Act).

#### 5. Statement Required Although No Securities are Owned

If any person required to file a statement on this form does not own any securities required to be reported, a statement shall be made on this form to report that fact.

#### 6. Reporting of Ownership in Certain Cases

(a) When two or more securities are owned as a unit and both are required to be reported, report each security separately and describe the unit relationship in the space provided for explanation on the form. If one or more of the securities comprising the unit is not required to be reported, the other security or securities shall be reported separately and the unit relationship described as indicated above.

(b) Securities owned indirectly shall be reported on separate lines from those owned directly and also from those owned through a different type of indirect ownership.

(c) In reporting the ownership of common stock that is convertible into another type of common stock, the stock should be listed in Table I with the number of shares or units subject to the conversion privilege and the conversion price per share or unit set forth in the explanation space. Other convertible securities shall be reported as derivative securities.

#### 7. Title of Securities

The title of securities in Column 1 of Table I and Columns 1 and 2 of Table II shall be stated as specifically as

possible; for example, "Common Stock," "Class A Common Stock," "\$6 Convertible Preferred Stock," etc. Include the name of the issuer of the securities if it is a public utility holding company or a subsidiary thereof.

#### 8. Statement of Amounts of Securities

(a) In stating amounts of securities in Column 2 of Table I and Column 3 of Table II, give the number of securities, or if debt is required to be reported, give the face amount of the debt securities.

(b) In stating amounts of securities beneficially owned through a partnership, corporation, trust, or other entity, the reporting person shall indicate only the amount of securities representing his proportionate interest in the holdings of the partnership, corporation, trust, or other entity. See Instruction 9(b) below. Alternatively, at the option of the reporting person, the entire amount of the entity's interest may be reported.

#### 9. Type of Ownership of Securities

(a) The following securities shall be reported as owned directly: Securities held in the name of the reporting person or in the name of a bank, broker, or nominee for the account of the reporting person; and securities held in joint tenancy, tenancy in common, tenancy by the entirety, or as community property.

(b) Securities that are beneficially owned, but that are not owned directly, e.g., through a spouse, child, or other member of the reporting person's immediate family, shall be reported as indirectly owned; "beneficial owner" and "immediate family" are defined in Rules 16a-1 (a) and (b), respectively.

Furthermore, securities holdings attributed to a reporting person due to the person's interest in a partnership, corporation, trust, or other entity also are considered to be owned indirectly.

(c) Beneficial ownership of the securities reported on this form may be disclaimed. See Rule 16a-1(a)(4).

#### 10. Type of Derivative Security

The type of derivative security owned shall be reported in Column 1 of Table II. If appropriate, state whether it represents a right to buy, a right to sell, an obligation to buy, or an obligation to sell, the securities subject to the derivative security.

#### 11. Inclusion of Additional Information

A statement may include any additional information or explanation deemed relevant by the person filing the statement.

#### 12. Signature

If the statement is filed for a corporation, partnership, trust or other entity, the name of the organization shall appear over the signature of the officer or other person authorized to sign the statement. If the statement is filed for an individual, it shall be signed by the individual or specifically on behalf of the individual by a person authorized to sign for the individual. If signed on behalf of the individual by another person, the authority of such person to sign the statement shall be confirmed to the Commission in writing as soon as practicable by the individual for whom the statement is filed, unless such a confirmation which is still in effect is on file with the Commission.

BILLING CODE 8010-01-M

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM 3**

**INITIAL STATEMENT OF BENEFICIAL OWNERSHIP OF SECURITIES**  
Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the  
Public Utility Holding Company Act of 1935, or Section 30(f) of the Investment Company Act of 1940

(Please Print or Type)

1. REPORTING PERSON: NAME (Last, First, Middle)	ADDRESS	CITY	STATE	ZIP CODE
2. ISSUER COMPANY: NAME	ADDRESS	CITY	STATE	ZIP CODE
3. ISSUER COMPANY STATE OF INCORPORATION	4. IRS OR SOC. SEC. IDENTIFYING NUMBER OF REPORTING PERSON (optional)			
5. JOB TITLE OF OFFICER/DIRECTOR (e.g. "President and Director," "Chief Financial Analyst," etc.)	5. RELATIONSHIPS OF REPORTING PERSON TO COMPANY (Check all which apply) DIRECTOR <input type="checkbox"/> OFFICER <input type="checkbox"/> 10% OWNER <input type="checkbox"/> OTHER (Specify):			
6. DATE OF EVENT REQUIRING FILING OF THIS STATEMENT	8. IF AN AMENDMENT, GIVE DATE OF STATEMENT TO BE AMENDED.			
MONTH DAY YEAR	MONTH DAY YEAR			

**TABLE I. SECURITIES BENEFICIALLY OWNED**

Furnish the information required by the following table as to securities beneficially owned directly or indirectly by the reporting person, including derivative securities required to be reported in Table II. (Instructions 4 and 6)

1. Title of Securities Owned (Report different types of ownership on separate lines) (Instruction 7)	2. Amount of Securities Owned (Instruction 8)	3. Type of Ownership (Place a "Y" in appropriate category) (Instruction 9) DIRECT _____ INDIRECT _____	4. Nature of Indirect Ownership (e.g. "By Spouse," "By X Trust," "By Y Corporation," "By Self as Trustee for Children," etc.)

**TABLE II. DERIVATIVE SECURITIES**

Furnish the information required by the following table as to all derivative securities of the company owned by the reporting person (The term "derivative securities" is defined in Rule 16(a)-1(c) (Instructions 4 and 6))

1. Title and Type of Derivative Security (Instructions 7 and 10)	2. Title of Securities Subject to Derivative Security (Report different types of ownership on separate lines) (Instruction 7)	3. Amount of Securities Subject to Derivative Security (Instruction 8)	4. Purchase or Sale Price of Securities Subject to Derivative Security	5. Date Derivative Security Becomes Exercisable if not Presently Exercisable	6. Date of Expiration of Derivative Security	7. Type of Ownership (Place a "Y" in appropriate category) (Instruction 9) DIRECT _____ INDIRECT _____	8. Nature of Indirect Ownership (e.g. "By Spouse," "By X Trust," "By Y Corporation," "By Self as Trustee for Children," etc.)

Explanation of items in tables:

DATE OF STATEMENT

SIGNATURE OF REPORTING PERSON (Instruction 12)

NOTE: If the space provided in either table is insufficient, use a continuation sheet which identifies the table and columns to which it relates.

BILLING CODE 8010-01-C

OMB APPROVAL  
OMB Number 3235-0104  
Expires: Pending Approval  
Estimated average burden hours per response . . . . . 0.5

**Form 4—Statement of Changes in Beneficial Ownership of Securities**  
**Special Instructions for Completing Form 4**

Under sections 16(a) and 23(a) of the Securities Exchange Act of 1934; sections 17(a) and 20(a) of the Public Utility Holding Company Act of 1935; and sections 30(f) and 38 of the Investment Company Act of 1940, and the rules and regulations thereunder, the Commission is authorized to solicit the information required to be supplied by this form by officers, directors and certain security holders of registered issuers.

Disclosure of the information specified in this form is mandatory, except for social security account numbers, disclosure of which is voluntary. The information will be used for the primary purpose of determining and disclosing the holdings of officers, directors and beneficial owners of registered companies. This statement will be made a matter of public record. Therefore, any information given will be available for inspection by any member of the public.

Because of the public nature of the information, the Commission can utilize it for a variety of purposes, including referral to other governmental authorities or securities self-regulatory organizations for investigatory purposes or in connection with litigation involving the Federal securities laws or other civil, criminal or regulatory statutes or provisions. Social security account numbers, if furnished, will assist the Commission in identifying officers, directors and security holders and, therefore, in promptly processing statements of changes in beneficial ownership of securities.

Failure to disclose the information requested by this form, except for social security account numbers, may result in civil or criminal action against the persons involved for violation of provisions of the Federal securities laws and rules promulgated thereunder.

**General Instructions**

**1. When and Where Statements Are To Be Filed**

(a) On or before the 10th day after the end of the month in which any change in beneficial ownership has occurred, three copies of the statement on this form, at least one of which is manually signed, shall be filed with the Securities and Exchange Commission, Washington, DC 20549. At the same time, one duplicate original of the statement shall be filed with each exchange on which any class of equity securities of the company is registered, unless the company has, in

accordance with Rule 16a-3(c), designated a single exchange to receive such statements. One duplicate original also shall be filed with the company pursuant to Rule 16a-3(e). The filing date is the date of receipt at the Commission except as otherwise provided.

(b) Acknowledgement of receipt of the statement by the Commission may be obtained by enclosing a self-addressed, stamped postal card identifying the statement filed.

**2. Separate Statement for Each Company—Exception**

A separate statement shall be filed with respect to the securities of each company, except that a single statement shall be filed with respect to the securities of a registered public utility holding company and all of its subsidiary companies.

**3. Classes of Securities To Be Reported**

(a) Persons reporting pursuant to section 16(a) of the Securities Exchange Act of 1934 shall include information required to be reported as to certain changes in the amount of securities beneficially owned, changes in the nature of beneficial ownership, and the amount of their beneficial ownership at the end of the month of all classes of equity securities of the company, even though one or more of such classes may not be registered pursuant to section 12 of the Act.

(b) Persons reporting pursuant to section 17(a) of the Public Utility Holding Company Act of 1935 shall include information required to be reported as to certain changes in the amount of securities beneficially owned, changes in the nature of beneficial ownership and the amount of their beneficial ownership at the end of the month of all classes of securities of the registered holding company and all of its subsidiary companies.

(c) Persons reporting pursuant to section 30(f) of the Investment Company Act of 1940 shall include information required to be reported as to certain changes in the amount of securities beneficially owned, changes in the nature of beneficial ownership and the amount of their beneficial ownership at the end of the month of all classes of securities of the registered closed-end investment company (other than "short-term paper," as defined in section 2(a)(38) of the Act).

**4. Transactions to Be Reported**

The following transactions which result in a change of beneficial ownership should be reported on Form 5 rather than this form: Stock splits and

stock dividends occurring during the fiscal year; small acquisitions that are to be reported on a deferred basis pursuant to Rule 16a-6; and transactions conducted during the company's fiscal year that were exempt from the provisions of section 16(b) of the Exchange Act by operation of any rule pursuant to such section. All other transactions which result in a change of beneficial ownership in the company's securities shall be reported on this form, except those that are excluded from the reporting and liability provisions of section 16 by operation of Rule 16a-5, 16a-7, 16a-8 or 16a-9. Transactions required to be reported on this form shall be reported even though acquisitions and dispositions during the month are equal, or the change involves only the nature of ownership, such as a change from indirect ownership through a trust or corporation to direct ownership by the reporting person.

**5. Reporting of Transactions**

(a) When a transaction relates to the acquisition or disposition of two or more securities as a unit and both are required to be reported, report each security separately and describe the unit relationship in the space provided for explanation. If one or more of the securities comprising the unit is not required to be reported, the other security or securities shall be reported separately and the unit relationship described as indicated above.

(b) Securities owned indirectly shall be reported on separate lines from those owned directly and also from those owned through a different type of indirect ownership.

(c) In reporting the acquisition or disposition of common stock that is convertible into another type of common stock, the transaction should be listed in Table I with the number of shares or units subject to the conversion privilege and the conversion price per share or unit set forth in the explanation space. Other convertible securities shall be reported as derivative securities.

**6. Title of Securities**

The title of securities in Column 1 of Table I and Columns 1 and 3 of Table II shall be stated as specifically as possible; for example, "Common stock," "Class A stock," "\$6 Convertible Preferred Stock," etc. Include the name of the issuer of the securities if it is a public utility holding company or a subsidiary thereof.

**7. Statement of Amounts of Securities**

(a) In stating amounts of securities in Columns 3, 4 and 7 of Table I and

Columns 4 and 7 of Table II, give the number of securities, or if debt is required to be reported, give the face amount of the debt securities.

(b) In stating amounts of securities beneficially owned through a partnership, corporation, trust, or other entity, the reporting person shall indicate only the amount of securities representing the proportionate interest of the person in the transaction conducted by the partnership, corporation, trust, or other entity. Alternatively, at the option of the reporting person, the entire amount of the entity's interest may be reported. See Instruction 9(b) below.

#### 8. Purchase or Sale Price of Securities

(a) If any transaction reported in Table I or II involved a purchase or sale of securities for cash or obligation to pay cash, state in Column 6 the purchase price per share or other unit, exclusive of brokerage commissions or other costs of execution. If the transaction was only partly for cash and partly for other consideration, state the amount of cash per share or other unit and the nature of the additional consideration. If the transaction did not involve cash, state the nature of the consideration given or received.

(b) When two or more securities are purchased or sold as a unit, the purchase or sale price of the unit shall be stated in Column 6 with respect to one of the securities and cross-referenced with respects to the other security or securities.

#### 9. Type of Ownership of Securities

(a) The following securities shall be reported as owned directly: Securities held in the name of the reporting person or in the name of a bank, broker or nominee for the account of the reporting person; and securities held in joint tenancy, tenancy in common, tenancy by the entirety or as community property.

(b) Securities that are beneficially owned, but that are not owned directly, e.g., through a spouse, child, or other member of the reporting person's immediate family, shall be reported as indirectly owned; "beneficial owner" and "immediate family" are defined in Rules 16a-1(a) and (b), respectively. Furthermore, securities holdings attributed to a reporting person due to the interest of the person in a partnership, corporation, trust, or other entity also are considered to be owned indirectly.

(c) Beneficial ownership of the securities reported on this form may be disclaimed. See Rule 16a-1(a)(4).

#### 10. Beneficial Ownership at End of Month

Beneficial ownership at the end of the month covered by the statement (Column 7 of Tables I and II) of all accounts required to be reported shall be shown even though there has been no change during the month in the ownership of securities of one or more classes or accounts. For example, a person reporting a transaction relating to common stock shall in addition to providing all the information in Table I

relating to such transaction, report the amount of preferred stock, convertible debentures, etc., owned at the end of the month.

#### 11. Type of Derivative Security

The type of derivative security owned shall be reported in Column 1 of Table II. If appropriate, state whether the derivative security represents a right to buy, a right to sell, an obligation to buy, or an obligation to sell, the underlying securities; for example, "Purchase of Put," "Sale of Put," "Purchase of Call," "Sale of Call," etc.

#### 12. Inclusion of Additional Information

A statement may include any additional information or explanation deemed relevant by the person filing the statement.

#### 13. Signature

If the statement is filed for a corporation, partnership, trust, etc., the name of the organization shall appear over the signature of the officer or other person authorized to sign the statement. If the statement is filed for an individual, it shall be signed by the individual or specifically on behalf of the individual by a person authorized to sign for the individual. If signed on behalf of the individual by another person, the authority of such person to sign the statement shall be confirmed to the Commission in writing as soon as practicable by the individual for whom the statement is filed, unless such a confirmation which is still in effect is on file with the Commission.

BILLING CODE 8010-01-M

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 4

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES  
Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the  
Public Utility Holding Company Act of 1935, or Section 30(f) of the Investment Company Act of 1940

(Please Print or Type)

1. REPORTING PERSON: NAME (Last, First, Middle)		ADDRESS		CITY	STATE	ZIP CODE
2. ISSUER COMPANY: NAME		ADDRESS		CITY	STATE	ZIP CODE
3. ISSUER COMPANY STATE OF INCORPORATION		4. IRS OR SOC. SEC. IDENTIFYING NUMBER OF REPORTING PERSON (Optional)		5. RELATIONSHIP(S) OF REPORTING PERSON TO COMPANY (Check all which apply) <input type="checkbox"/> DIRECTOR <input type="checkbox"/> OFFICER <input type="checkbox"/> 10% OWNER <input type="checkbox"/> OTHER (Specify)		
6. JOB TITLE OF OFFICER/DIRECTOR (e.g., "President and Director," "Chief Financial Analyst," etc.)		7. STATEMENT FOR CALENDAR MONTH OF MONTH _____ YEAR _____		8. DATE OF LAST PREVIOUS STATEMENT MONTH _____ DAY _____ YEAR _____		
				9. IF AN AMENDMENT, GIVE DATE OF STATEMENT TO BE AMENDED MONTH _____ DAY _____ YEAR _____		

TABLE I. SECURITIES BOUGHT, SOLD, OR OTHERWISE DISPOSED OF

Furnish the information required to be reported on this form as to securities of the company bought or sold or otherwise acquired or disposed of by the Reporting person during the month for which this statement is filed. (Instructions 4 and 5) Transactions involving derivative securities of the company shall be reported in Table II.

1. Title and Type of Derivative Security (Instructions 6 and 11)	2. Date of Transaction (Give trade date of market transactions) MONTH DAY YEAR	3. Amount of Securities Acquired (Instruction 7)	4. Amount of Securities Disposed (Instruction 7)	5. Code for Character of Transaction (See Below)	6. Purchase or Sale Price Per Share or Other Unit (Instruction 8)	7. Amount of Securities Owned At End of Month (Instruction 7)	8. Type of Ownership (Place a "y" in appropriate category (Instruction 9)) DIRECT INDIRECT	9. Nature of Indirect Ownership (e.g., "By Spouse," "By X Trust," "By Y Corporation," "By Self as Trustee for Children," etc.)

TABLE II. DERIVATIVE SECURITIES

If, during the month for which this statement is filed, the reporting person acquired or disposed of any derivative security required to be reported on this form, furnish the following information (the term "derivative securities" is defined in Rule 16a-1(c) (Instructions 4 & 5))

1. Title and Type of Derivative Security (Instructions 6 and 11)	2. Date of Transaction (Give trade date of market transactions) MONTH DAY YEAR	3. Title of Securities Subject to Derivative Security (Instruction 6)	4. Amount of Securities Subject to Derivative Security (Instruction 7)	5. Code for Character and Transaction (See Codes Below)	6. Purchase or Sale Price of Derivative Security (Instruction 8)	7. Amount of Securities Subject to Derivative Security (Instruction 9)	8. Purchase or Sale Price of Securities Subject to Derivative Security (Instruction 9)	9. Date Derivative Security Becomes Exercisable if not Previously Exercisable MONTH DAY YEAR	10. Date of Expiration of Derivative Security (Instruction 9) MONTH DAY YEAR	11. Type of Ownership (Place a "y" in appropriate category (Instruction 9)) DIRECT INDIRECT	12. Nature of Indirect Ownership (e.g., "By Spouse," "By X Trust," "By Y Corporation," "By Self," etc.)

CODES FOR CHARACTER OF TRANSACTION (Enter in Item 5 of Tables I and II)

(P) — Open Market Purchase	(D) — Stock Dividend	(F) — Disposed of by Conversion of Out of the Money Derivative Security	(U) — Other Disposition (Specify)
(S) — Open Market Sale	(O) — Acquired by Exercise of Out of the Money Derivative Security	(E) — Expiration of Out of the Money Derivative Security (if short position)	
(J) — Private Purchase	(CO) — Disposed of by Conversion of Out of the Money Derivative Security	(B) — Acquisition Pursuant to Qualified Benefit Plan	
(K) — Private Sale	(C) — Acquired by Conversion of Out of the Money Derivative Security	(I) — Other Acquisition (Specify)	

Explanation of items in tables.

DATE OF STATEMENT

SIGNATURE OF REPORTING PERSON (Instruction 13)

NOTE: If the space provided in either table is insufficient, use a continuation sheet which identifies the table and columns to which it relates.

BILLING CODE 8010-01-C

OMB APPROVAL	
OMB Number: 3235-0287	Expires: Pending Approval
Estimated average burden hours per response: 00.5	

**Form 5—Annual Reconciliation of Beneficial Ownership of Securities**  
**Special Instructions for Completing Form 5**

Under sections 16(a) and 23(a) of the Securities Exchange Act of 1934; sections 17(a) and 30(a) of the Public Utility Holding Company Act of 1935; and sections 30 (f) and 38 of the Investment Company Act of 1940, and the rules and regulations thereunder, the Commission is authorized to solicit the information required to be supplied by this form by officers, directors and certain security holders of registered issuers.

Disclosure of the information specified in this form is mandatory, except for social security account numbers, disclosure of which is voluntary. The information will be used for the primary purpose of determining and disclosing the holdings of officers, directors and beneficial owners of registered companies. This statement will be made a matter of public record. Therefore, any information given will be available for inspection by any member of the public.

Because of the public nature of the information, the Commission can utilize it for a variety of purposes, including referral to other governmental authorities or securities self-regulatory organizations for investigatory purposes or in connection with litigation involving the Federal securities laws or other civil, criminal or regulatory statutes or provisions. Social security account numbers, if furnished, will assist the Commission in identifying officers, directors and security holders and, therefore, in promptly processing statements of beneficial ownership of securities on this form.

Failure to disclose the information requested by this form, except for social security account numbers, may result in civil or criminal action against the persons involved for violation of provisions of the Federal securities laws and the rules promulgated thereunder.

**General Instructions**

**1. When and Where Statements Are To Be Filed**

(a) On or before the 30th day after the end of the company's fiscal year, three copies of the statement on this form, at least one of which is manually signed, shall be filed with the Securities and Exchange Commission, Washington, DC 20549. At the same time, one duplicate original of the statement shall be filed with each exchange on which any class of equity securities of the company is registered, unless the company has in

accordance with Rule 16a-3(c), designated a single exchange to receive such statements. One duplicate original also shall be filed with the company pursuant to Rule 16a-3(e). The filing date is the date of receipt at the Commission except as otherwise provided by Rule 16a-3(g).

(b) Acknowledgment of receipt of the statement by the Commission may be obtained by enclosing a self-addressed, stamped postal card identifying the statement filed.

**2. Separate Statement for Each Company—Exception**

A separate statement shall be filed with respect to the securities of each company, except that a single statement shall be filed with respect to the securities of a registered public utility holding company and all of its subsidiaries.

**3. Classes of Securities To Be Reported**

(a) Persons reporting pursuant to section 16(a) of the Securities Exchange Act of 1934 shall include information as to transactions required to be reported on this form in all classes of equity securities of the company even though one or more of such classes may not be registered pursuant to section 12 of the Act.

(b) Persons reporting pursuant to section 17(a) of the Public Utility Holding Company Act of 1935 shall include information as to transactions required to be reported on this form in all classes of securities of the registered holding company and all of its subsidiary companies.

(c) Persons reporting pursuant to section 30(f) of the Investment Company Act of 1940 shall include information as to transactions required to be reported on this form in all classes of securities of the registered closed-end investment company (other than "short-term paper", as defined in section 2(a)(38) of the Act).

**4. Statement Required Even if No Transactions Have Been Conducted or No Securities Are Owned**

A statement on this form is required regardless of whether the reporting person conducted any transactions in the company's securities during the company's fiscal year. See Rule 16a-3(f). If any person required to file a statement on this form does not own any securities required to be reported, a statement shall be made on this form to report that fact.

**5. Transactions To Be Reported**

Stock splits or stock dividends occurring during the fiscal year shall be reported on this form. See Rule 16a-

3(f)(1). Small acquisitions that are to be reported on a deferred basis pursuant to Rule 16a-6 shall be reported on this form. In accordance with Rule 16a-3(f)(1), all transactions in the company's securities conducted during the company's fiscal year that were exempted from liability under section 16 of the Exchange Act (by operation of rules promulgated pursuant to section 16(b) of such Act) and, therefore, are to be reported on a deferred basis, shall be reported on this form. Any occurrence or transaction required to be reported on Form 3 or 4 under section 16(a) of the Act that was required to be filed prior to, and that has yet to be reported as of the date by which this Form 5 is filed shall be reported on this Form 5; *Provided, however*, that such Form 3 or 4 shall be appended to this Form 5. Transactions involving derivative securities shall be reported in Table II; all other transactions shall be reported in Table I.

**6. Reporting of Transactions**

(a) When a transaction relates to the acquisition or disposition of two or more securities as a unit and both are required to be reported, report each security separately and describe the unit relationship in the space for comments below Table II. If one or more of the securities comprising the unit is not required to be reported, the other security or securities shall be reported separately and the unit relationship described as indicated above. In reporting the acquisition or disposition of common stock that is convertible into another type of common stock, the transaction should be listed in Table I with the number of shares or units subject to the conversion privilege and the conversion price set forth in the space for comments below Table II. Other convertible securities should be reported as derivative securities.

(b) Securities owned indirectly shall be reported on separate lines from those owned directly and also from those owned through a different type of indirect ownership.

(c) If a derivative security is converted or exercised, the transaction shall be reported in Table II and the acquisition or disposition of the security subject to the derivative security shall be reported in Table I.

**7. Title of Securities**

The title of securities in Column 1 of Table I and Columns 1 and 3 of Table II shall be stated as specifically as possible; for example, "Common stock," "Class A common stock," "\$6 Convertible Preferred Stock," etc.

Include the name of the issuer of the securities if it is a public utility holding company or a subsidiary thereof.

#### 8. Statement of Amounts of Securities

(a) In stating amounts of securities in Columns 3 and 4 of Table I and Column 4 of Table II and in Section A under the heading "Additional Information," give the number of securities, or if debt is required to be reported, give the face amount of the debt securities.

(b) In stating amounts of securities beneficially owned through a partnership, corporation, trust, or other entity, the reporting person shall indicate only the amount of securities representing the proportionate interest of the person in the transaction or holdings of the partnership, corporation, trust, or other entity. See Instruction 10(b) below. Alternatively, at the option of the reporting person, the entire amount of the entity's interest may be reported.

#### 9. Purchase or Sale Price of Securities

(a) If any transaction reported in Table I or II involved a purchase or sale of securities for cash or obligation to pay cash, state in Column 6 the purchase price per share or other unit, exclusive of brokerage commissions or other costs of execution. If the transaction was only partly for cash and partly for other consideration, state the amount of cash per share or other unit and the nature of the additional consideration. If the transaction did not involve cash, state the nature of the consideration given or received.

(b) When two or more securities are purchased or sold as a unit, the purchase or sale price of the unit shall be stated in Column 6 with respect to one of the securities and cross-referenced with respect to the other security or securities.

#### 10. Type of Ownership of Securities

(a) The following securities shall be reported as owned directly: Securities held in the name of the reporting person or in the name of a bank, broker, or nominee for the account of the reporting

person; and securities held in joint tenancy, tenancy in common, tenancy by the entirety, or as community property.

(b) Securities that are beneficially owned, but that are not owned directly, e.g., through a spouse, child, or other member of the reporting person's immediate family, shall be reported as indirectly owned; "beneficial owner" and "immediate family" are defined in Rules 16a-1(a) and (b), respectively. Furthermore, securities holdings attributed to a reporting person due to the person's interest in a partnership, corporation, trust, or other entity also are considered to be owned indirectly.

(c) Beneficial ownership of the securities reported on this form may be disclaimed. See Rule 16a-1(a)(4).

#### 11. Type of Derivative Security

The type of derivative security owned shall be reported in Column 1 of Table II. If appropriate, state whether the derivative security represents a right to buy, a right to sell, an obligation to buy, or an obligation to sell, the underlying securities; for example, "Purchase of Put," "Sale of Put," "Purchase of Call," "Sale of Call," "Acquisition of Warrant," "Disposition of Warrant," "Exercise of Rights," etc.

#### 12. Beneficial Ownership at End of Fiscal Year

(a) The title and amount of securities beneficially owned by the reporting person as of the last day of the company's fiscal year shall be disclosed in Part A of this form. See Instructions 7 and 8.

(b) When two or more securities are owned as a unit, report each security separately and describe the unit relationship in the space provided for comments below Part A. If one or more of the securities comprising the unit is not required to be reported, the other security or securities shall be reported separately and the unit relationship described as indicated above.

(c) In reporting the ownership of common stock that is convertible into another type of common stock, the

number of shares or units subject to the conversion privilege should be set forth in the space for comments below Part A. Other convertible securities should be reported as derivative securities.

#### 13. Certification of Compliance with Section 16(a)

(a) All reporting persons shall certify in Part B of the "additional information" section on page 2 of this form whether or not they have filed with the Commission and each exchange with which filing is required all required Form 3 or 4 reports relating to events occurring and/or transactions consummated during the company's fiscal year.

(b) If the certification cannot be given, the reporting person must either: (1) Provide an indication that three copies of all reports on Forms 3 and 4 that should have been, but were not, filed are attached to this Form; or (2) list the events and/or transactions that triggered the reporting requirements, the dates on which such events and/or transactions occurred, and explain why the required reports have not been filed.

#### 14. Inclusion of Additional Information

A statement may include any additional information or explanation deemed relevant by the person filing the statement.

#### 15. Signature

If the statement is filed for a corporation, partnership, trust, etc., the name of the organization shall appear over the signature of the officer or other person authorized to sign the statement. If the statement is filed for an individual, it shall be signed by the individual or specifically on behalf of the individual by a person authorized to sign for the individual. If signed on behalf of the individual by another person, the authority of such person to sign the statement shall be confirmed to the Commission in writing as soon as practicable by the individual for whom the statement is filed, unless such a confirmation which is still in effect is on file with the Commission.

BILLING CODE 8010-01-M

U.S. Securities and Exchange Commission  
Washington, D.C. 20549

Washington, D.C. 20549

## Form 5

Annual Report of Beneficial Ownership of Securities  
Filed Pursuant to Section 16(a) of the Securities Exchange Act of 1934,  
Section 17(a) of the Public Utility Holding Company Act of 1935,  
or Section 30(f) of the Investment Company Act of 1940

OMB APPROVAL	
OMB Number:	3235-0xxx
Expires:	Pending Approval
Estimated average burden hours per response....	1.00

1. Name and Address of Reporting Person Last, First, Middle	2. Name and Address of Issuer Company Name	3. Issuer Company State of Incorporation	5. Relationship of Reporting Person to Company (Check all which apply)
Number and Street	Number and Street	4. IRS or Social Security Identifying Number of Reporting Person (Optional)	<input type="checkbox"/> Director <input type="checkbox"/> Officer <input type="checkbox"/> 10% Owner <input type="checkbox"/> Other (Specify)
City, State, Zip Code	City, State, Zip Code	7. Statement for Company's Fiscal Year Ending Month Day Year	8. If an Amendment, give date of Statement to be Amended Month Day Year
6. Job Title of Officer/Director (e.g., President and Director, Chief Financial Officer, etc.)			

Table I - Securities Transactions Reported on a Deferred Basis

[illegible]

Codes for Character of Transaction (Enter in Item 5 of Tables I and II)	
Stock Split (Rule 16a-3(f)(1)).....	[Z]
Reverse Stock Split.....	[Y]
Small Acquisition (Rule 16a-6).....	[A]
Issuer Redemption (Rule 16b-4).....	[R]
Deposit or Withdrawal from Voting Trust or	
Depositor Agreement (Rule 16b-8).....	[V]
Acquired by Bonafide Gift (Rule 16b-5).....	[G]
Imposed by Bonafide Gift.....	[h]
Disposed of by Exercise of In-the-Money or	
At-the-Money Derivative Security (Rule 16b-6) [x]	
Disposed of by Exercise of In-the-Money or	
At-the-Money Derivative Security.....	[Q]
Transfer by Will or the Laws of Descent	
(Rule 16b-5).....	[W]
Acquired by Conversion of In-the-Money or	
At-the-Money Derivative Security (Rule 16b-6) [M]	
Disposed of by Conversion of In-the-Money	
or At-the-Money Derivative Security..... [N]	
Acquisition or Disposition Pursuant to	
Merger or Consolidation (Rule 16b-7)....	[I]
Acquisition Pursuant to Reinvestment of	
Dividends or Interest (Rule 16(b)-9)....	[L]
Other Acquisition (Specify).....	[U]
Other Disposition (Specify).....	[T]

**Table 11 - Derivative Securities Transactions Reported on a Deferred Basis  
(The Term "Derivative Securities" defined in Rule 16a-1(c)  
Instructions 5 and 6**

[illegible]

Comments regarding items in Tables I and II:

### ADDITIONAL INFORMATION

#### A. Securities Beneficially Owned (Instruction 12)

Furnish the following information as to securities of the company beneficially owned directly or indirectly as of the last day of the company's fiscal year (Report different types of ownership on separate lines):

1. Title and Type of Security (Other than derivative security) owned	Amount
2. Title and Type of Security Subject to Derivative Security owned	Amount

8. Certification of Compliance with Section 16(a) (Instruction 13)

1. The reporting person certifies that all Form 3 and Form 4 reports required by Section 16(a) relating to events occurring (i.e., person becomes officer, director or 10% owner of a registered company) and/or transactions consummated by the reporting person in the company's securities during the fiscal year have been filed with the Commission.....Check Box ☐ Yes ☐ No
2. If the above certification was not given, either:
- a. Attach three copies of all reports on Forms 3 or 4 relating to events occurring and/or transactions consummated during the company's fiscal year that should have been, but were not, filed with the Commission.
- or b. List below the events and/or transactions that triggered the reporting requirements, the date on which the events or transactions occurred, and explain why the required reports have not been filed to date:

## Comments

Event/Transaction	Date of Occurrence	Explanation

Date of Statement	Signature of Reporting Person (Instruc. 15)
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**Note:** If the space provided in any table is insufficient, use a continuation sheet which identifies the table and columns to which it relates.

# **PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940**

1. The authority citation for Part 270 continues to read as follows:

Authority: Secs. 38, 40, 54 Stat. 841, 842; 15 U.S.C. 80c-89; The Investment Company Act of 1940, as amended, 15 U.S.C. 80a-1 *et seq.*; unless otherwise noted.

2. Section 270.39f-1 is revised to read as follows:

## **§ 270.30f-1 Applicability of section 16 of the Exchange Act to section 30(f).**

(a) The filing of any statement prescribed under section 16(a) of the Securities Exchange Act of 1934, shall satisfy the corresponding requirements of section 30(f) of the Investment Company Act of 1940.

(b) The rule under section 16 of the Securities Exchange Act of 1934 shall apply to any duty, liability or prohibition imposed with respect to a transaction involving any security of a registered closed-end company under section 30(f) of the Act.

(c) No statement need be filed pursuant to section 30(f) of the Act by an affiliated person of an investment adviser in his capacity as such if such person is solely an employee; other than an officer, of such investment adviser.

# **PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940**

1. The authority citation for Part 274 continues to read in part as follows:

Authority: The Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.*

2. By adding sub-item 88.E. of Form N-SAR in § 274.101 to read as follows:

Note: Form N-SAR is not included in the Code of Federal Regulations.

Form N-SAR

\* \* \* \* \*

88.

E. Furnish the information required by Item 405 of Regulations S-K.

By the Commission.

Jonathan G. Katz,

Secretary.

December 2, 1988.

[FR Doc. 88-28284 Filed 12-12-88; 8:45 am]

BILLING CODE 8010-01-M

## **17 CFR Part 230**

[Rel. No. 33-6806, File No. S7-23-88]

## **Resale of Restricted Securities; Changes of Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145**

AGENCY: Securities and Exchange Commission.

ACTION: Extension of comment period.

**SUMMARY:** The Securities and Exchange Commission is extending from December 31, 1988 to January 31, 1989, the date by which comments on Securities Act Release No. 33-6806 (October 25, 1988) [53 FR 33147] regarding proposed Rule 144A and proposed changes to the method of determining the holding period of restricted securities under Rules 144 and 145 must be submitted.

**DATE:** Comments on Release No. 33-6806 must be received on or before January 31, 1989.

**ADDRESS:** Comments on Release No. 33-6806 should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. Comment letters should refer to File No. S7-23-88. All comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549.

**FOR FURTHER INFORMATION CONTACT:** Sara Hanks or Samuel Wolff, (202) 272-3246, Office of International Corporate Finance, Division of Corporation Finance, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549.

**SUPPLEMENTARY INFORMATION:** In Securities Act Release No. 33-6806, the Commission requested comments on proposed Rule 144A, which would provide a non-exclusive safe harbor from the registration requirements of the Securities Act for resales of securities to institutional investors. Release 6806 also proposed for comment amendments to Rules 144 and 145, changing the method of determining the holding period of restricted securities. In view of the many questions raised in the Release, potential commenters have requested additional time. The Commission had determined to extend the comment period from December 31, 1988 to January 31, 1989.

By the Commission.

Jonathan G. Katz,  
Secretary.

December 2, 1988.

[FR Doc. 88-28602 Filed 12-2-88; 8:45 am]

BILLING CODE 8010-01-M

## **DEPARTMENT OF LABOR**

## **Occupational Safety and Health Administration**

## **29 CFR Part 1926**

[Docket No. S-301B]

## **Concrete and Masonry Construction Safety Standards; Lift-Slab Construction**

AGENCY: Occupational Safety and Health Administration (OSHA), Labor.

ACTION: Extension of written comment period and period for requesting an informal hearing.

**SUMMARY:** This notice extends the time in which written comments and requests for a hearing may be submitted concerning the notice of proposed rulemaking which OSHA issued on September 15, 1988 [53 FR 35972] on lift-slab construction. This notice also restates the procedures for submitting hearing requests.

**DATE:** Written comments and requests for a hearing must be postmarked by February 12, 1989.

**ADDRESS:** Comments and requests for a hearing must be submitted, in quadruplicate, to the Docket Office, Docket S-301B, Room N-2634, 200 Constitution Avenue NW., Washington, DC 20210. Telephone (202) 523-7894. All materials submitted will be available for public inspection and copying at the above address.

**FOR FURTHER INFORMATION CONTACT:** Mr. James Foster, U.S. Department of Labor, OSHA, Room N-3647, 200 Constitution Avenue NW., Washington, DC 20210. Telephone (202) 523-8151.

**SUPPLEMENTARY INFORMATION:** OSHA issued a Notice of Proposed Rulemaking on September 15, 1988, [53 FR 35972] which proposed to revise the safety standards for lift-slab construction. Interested parties were given until November 14, 1988, to submit comments pertaining to the proposal. The notice of proposed rulemaking also informed the public of the opportunity to request an informal public hearing on the proposal. Subsequently, OSHA received a request for an extension of the comment period. OSHA published a notice in the Federal Register on November 8, 1988 [53 FR